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3 keys for Dollarama's success: Pricing power, plastic and plans to expand

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A pedestrian walks past a Dollarama store in Ottawa, Ontario, Canada, September 1, 2016. , REUTERS/Chris Wattie

Stock-market darling Dollarama (**DOL.TO** **0.59%**) hit an all-time high on Friday, ahead of the company's first-quarter earnings release next week. The discount retailer has been on a tear over the course of the last year, riding rising same-store sales and aggressive expansion plans to a more than 40-per-cent increase in its share price -- easily outpacing the broader composite's 12-per-cent rise.

The analyst community has taken a largely rosy view of the stock, with 14 buys, four holds and no sell ratings. However, with an average 12-month target price of $124.65, the Street thinks the stock is fully (or even slightly over) valued.

A trio of factors will likely land in the spotlight in the first-quarter results:

DOLLAR-STORE NO MORE

In spite of its moniker, Dollarama's earnings have been boosted in recent quarters by an increase in sales of items priced above $1.25. In its most recent quarter, the retailer reported nearly 65 per cent of its sales originated from such products, up from 59.4 per cent in the corresponding period a year earlier. Though the company still touts the fact nothing it sells will run you more than $4, the prevalence of higher-priced items allows the company to boost its revenue per square foot and average transaction size, which rose 5.5 per cent in the fourth quarter.

PAYING WITH PLASTIC

Those larger baskets have been facilitated by increasing debit card penetration. Dollarama originally eschewed accepting debit cards due to the transaction costs borne by the company, but now accepts the form of payment in all of its stores. Debit transactions represented 49.2 per cent of sales in the last fiscal year, and the average debit card transaction is twice the value of cash-based sales. The retailer is expanding its payment offerings this year, rolling out credit card capability across the country in the second quarter in the wake of a pilot project in British Columbia, Alberta and New Brunswick. ***Ahmad Faheem***, an Equity Research Associate at ***Veritas Investment Research*** who covers the company, thinks accepting credit cards will be a boost to basket size, albeit at the expense of foot traffic.

"The acceptance and ramp-up of credit cards should result in the "traffic" metric becoming less meaningful to the overall [same store sales growth] number going forward as we expect Dollarama customers to consolidate shopping trips, causing negative traffic growth as seen during debit card ramp-up," ***Faheem*** told BNN in an email. We expect credit card use (typically 2.0 to 2.5 times the spending multiple of debit and cash purchases) to help the penetration of $3.50 and $4.00 price points and push the average transaction sizes higher. The combination should support a sustainable same store sales growth of 4% to 5%."

Faheem upgraded Dollarama to "buy" from "sell" with an intrinsic value of $130 on May 2, in part due to that same store sales growth.

EXPLOSIVE EXPANSION PLANS

Dollarama opened 65 stores over the course of the last fiscal year, bringing its total count to 1,095. The retailer hiked its long-term store growth forecast in the process, with management telling the investment community it thinks the chain can grow to 1,700 stores over the course of the next eight to 10 years, well above its previous forecast of 1,400 outlets. The company admits it expects some sales cannibalization as it nears 1,700 locations, but doesn't see it as a material impact for at least the next two years. Veritas' ***Faheem*** views the 1,700 figure as conservative, telling BNN his firm's analysis shows the potential for explosive growth in the overall sector, and thus, apportunity for more aggressive expansion.

"In our Forward Sortation Areas proximity analysis, we show that the Canadian Dollar Store market has potential to double stores by the year 2025 – Dollarama's current expansion plans accounts for less than 40% of this opportunity set," he wrote "Therefore, we view the 1,700 store target as a floor rather than a ceiling."

It also faces the specter of heightened competition, with rival Dollar Tree (**DLTR.O** **0.16%**) recently saying it sees an opportunity to boost its Canadian store count to 1,000 from the 226 locations it currently has north of the border.

Dollarama is expected to release results Wednesday, June 7 at 7:00 am Eastern. The average estimate is for 79 cents in earnings per share on $713 million in revenue.