Dollarama

Consumer Discretionary
TSE: DOL
Market Outperform | Buy

September 30, 2022

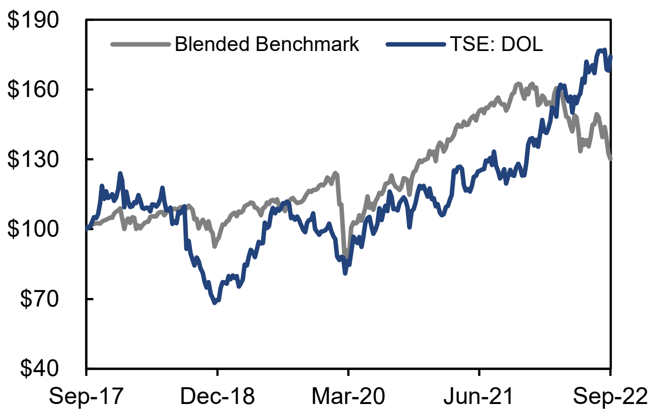
Daniel Krapiwin, Investment Analyst

Implied Return	
Current Share Price	$79.30
Target Price	$88.00
Dividend Yield	0.27%
Implied Return	11%
Conviction Rating	2

Market Profile	
52-Week Range	$54.28 - $83.95
Market Capitalization ($mm)	$22,793
Net Debt ($mm)	$3,849
Enterprise Value ($mm)	$26,642
Beta (5-Year Monthly)	0.78

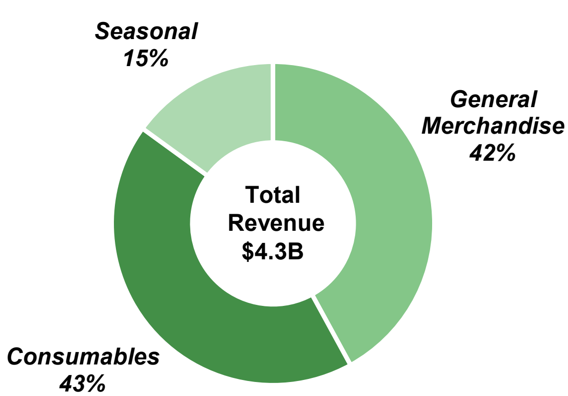
Metrics	2022E	2023E	2024E
Revenue ($mm)	$4,886	$5,397	$5,900
EBITDA ($mm)	$1,469	$1,622	$1,773
EPS ($)	$2.84	$3.27	$3.65
EV/EBITDA	18.1x	16.4x	15.0x

Historical Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: 2021 Revenue Segmentation



Source: Company Filings

Business Description

Dollarama Inc (TSE: DOL) is Canadian dollar store retail chain headquartered in Montreal, Canada. The Company owns and operates over ~1,400 locations across Canada. It sells both private and national brand labels at select fixed price points up to $5. The Company offers a broad assortment of goods in three main product categories: consumable products, general merchandise, and seasonal items.

Industry Overview

The Canadian variety store industry is forecasted to grow at a 1% CAGR until 2027 as the market becomes saturated. This industry experiences lower growth compared to traditional department stores which are expected to grow at a 2.6% CAGR until 2027. Consolidation and regulation surrounding sustainability in the industry have created higher entry costs for firms entering the space, making it increasingly competitive. Critical success factors include the successful promotion of products, maintaining desired inventory, and ensuring an appropriate pricing policy. DOL has excelled in these factors and currently holds the leading market share at 68.8%, followed by Dollar Tree (NASDAQ: DLTR) at 8.7%. Consolidated retailers remain relatively unscathed by inflation due to their ability to purchase in bulk and take advantage of economies of scale.

Dollarcity

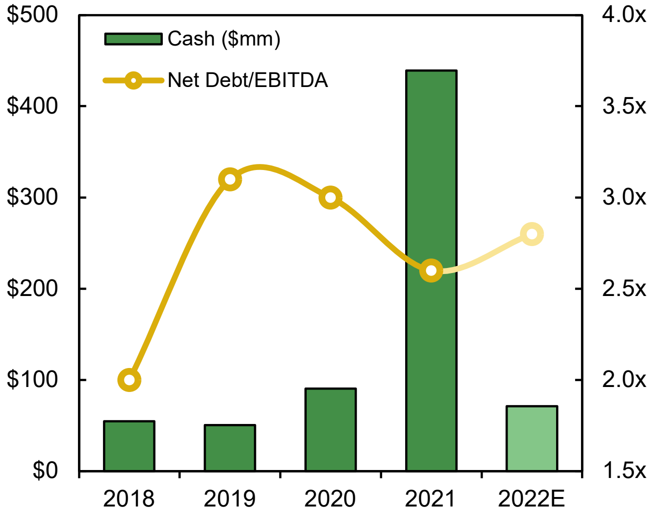
In 2019, DOL acquired a majority interest (50.1%) in the Latin American (LATAM) discount retailer, Dollarcity, for US$93mm, which was immediately accretive to earnings. As of June 30, 2022, Dollarcity had 377 operational stores across four countries including Colombia, Guatemala, El Salvador, and Peru. Dollarcity operates under the same business strategy as DOL, selling items at fixed price points up to US$4. Dollarcity had annual sales of US$501mm and contributed $33mm to DOL's consolidated earnings in 2021. The Company targets a store count of 600 by 2029, implying 32 additional new stores per year. The CPMT views Dollarcity as an attractive opportunity from which DOL can experience new growth in established and emerging LATAM Markets.

Mandate Fit

Quality Management: Neil Rossy became President and CEO of the Company in 2016. He has been with DOL since its inception in 1992, providing him with over 30 years of firm-specific experience. This expertise will be beneficial to DOL's Latin American expansion strategy by providing smoother and more efficient growth in this new market. DOL maintains independence in seven of its nine board members and provides high long-term at-risk pay (58.6%) for management. Management has returned over $6B in dividends and share buybacks to shareholders since DOL went public in 2012.

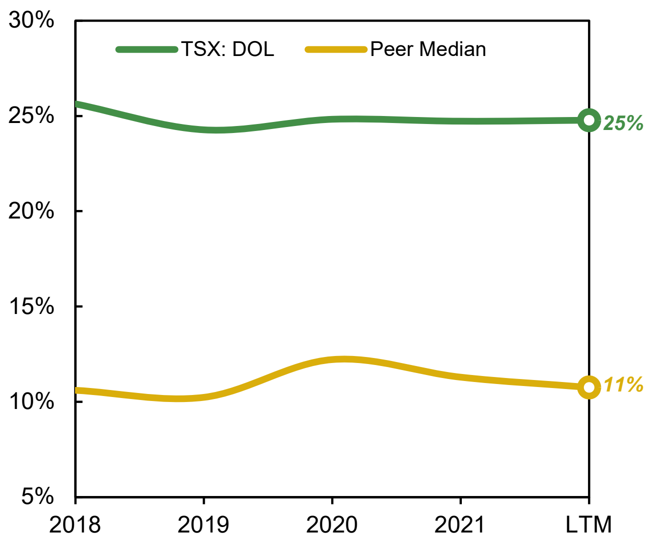
Competitive Advantage: DOL uses a direct sourcing strategy, importing from over 1,350 distinct and socially responsible vendors. By doing so, the Company provides customers with a 25-60% discount on household items compared to upscale retailers. This provides immense value to low-income demographics and enables consumers to preserve the purchasing power of their dollar in the current inflationary environment, allowing DOL to attract (cont.)

Figure 2: LHS Cash vs RHS Net Debt/EBITDA



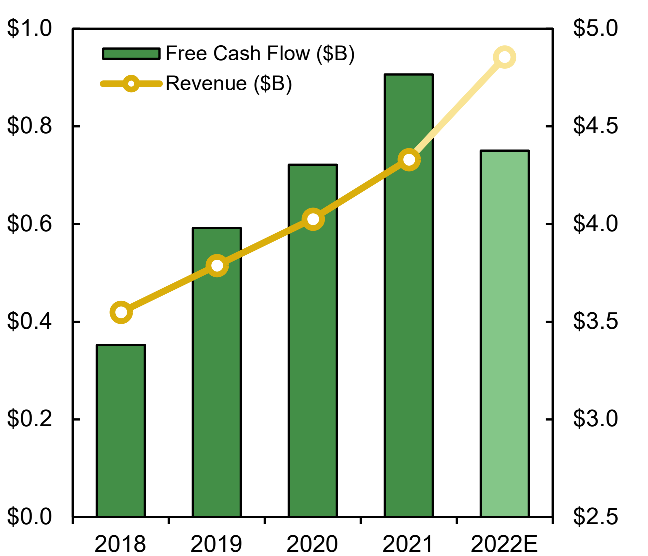
Source: Company Filings

Figure 3: EBITDA Margin vs Peers



Source: Company Filings

Figure 4: LHS Free Cash Flow vs RHS Revenue



Source: Company Filings

consumers away from higher-priced stores. The Company's lean operations and stable growth enables efficient expansion. On average, new stores cost $0.65mm to open, with $0.25mm devoted to inventory. New stores have a cash payback period of fewer than two years. Compared to peers, the Company holds its suppliers to a higher standard of ethics, providing a competitive edge from an ESG standpoint. The Company also has geographical diversification through Dollarcity, which is unique to North American value retailers.

Balance Sheet: DOL has consistently maintained a Net Debt/EBITDA ratio of less than 3.0x, which is in line with management's target and slightly above the peer median of 2.7x. The Company boasts a 13.7x interest coverage as of Q2 2022 and has a current ratio of 0.8x, excluding the additional $650mm it has available on its credit facility. As a result, DOL can continue its expansion strategy of opening 65 stores per year on average without sacrificing its balance sheet strength.

Growing Free Cash Flow: In 2022, DOL allocated a significant portion of its cash to restoring inventory to pre-pandemic levels and maintaining higher levels of inventory-in-transport. This strategy will help mitigate any supply chain uncertainties. Forecasted cash flows in 2022 may be lower than in 2021 due to this increase in net working capital. However, DOL has consistently grown its free cash flow and has achieved a 16.3% five-year CAGR.

Original Investment Thesis

The CPMT has previously held DOL and believed that the Company had a significant runway for growth given its dominant market share in Canada. It was also recognized that Dollarcity could provide growth in the LATAM market and protection in the event of an economic downturn. In 2021, the CPMT liquidated its position in DOL due to the Company's inability to gain market share and COVID-19 restrictions forcing DOL to close some of its storefronts. Though DOL has not gained significant market share, it has grown its footprint substantially and has begun to rival peers like Walmart (NYSE: WMT) and Canadian Tire (TSX: CTC.A) for low-cost items.

Risks

DOL has historically held tight relationships with its suppliers, which is partially why the Company can achieve incredibly high EBITDA margins (25.6%). A failure to maintain these relationships could impact sourcing capabilities which may result in decreased financial performance pushing the Company closer to peers. Additionally, the Company is exposed to inflationary pressures on its purchases. However, it remains relatively protected due to its multi-point pricing strategy, which allows some costs to be transferred to consumers.

Valuation & Investment Thesis

DOL was valued using a five-year DCF (7.6% WACC) with a 50/50 blend of (1) a 2023E EV/EBITDA exit multiple of 17.5x and (2) the Gordon Growth method using a long-term growth rate of 1.5%. This resulted in a target price of $88, implying an 11% return. DOL's margin control through its multiple price-point strategy along with its superior sourcing capabilities enables the Company to achieve an impressive ROIC (21.1%) compared to peers. Additionally, DOL has a strong brand awareness, appeals to a broad customer base, and provides significant discounts compared to peers. This positions it to increase sales during an economic downturn as consumers search for quality low-cost products. The Company also offers appealing geographical optionality for growth through Dollarcity in LATAM, and its defensive properties appeal to current market conditions. The fund looks to enter a position in DOL pending further due diligence.