THE GLOBE AND MAIL

June 5, 2016

Grim U.S. jobs numbers may be bad news for Canada

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After last week's shockingly bad employment report raised fresh doubts about the U.S. economy's strength, economists will be watching closely this week for signs that the weakness may be spilling over to Canada.

The gain of just 38,000 U.S. non-farm jobs in May – well below expectations of 160,000 – was the worst showing in nearly six years. Combined with downward revisions for both March and April, the sluggish jobs market has dimmed hopes for a strong U.S. economic rebound in the second quarter and all but eliminated the possibility of a rate hike at the Federal Open Market Committee's June 14-15 meeting.

Even before the grim U.S. jobs numbers, Canada's economy was already sputtering.

"Canada is going to suffer through an abysmal Q2, with GDP [gross domestic product] falling by roughly 1 per cent annualized, and little growth even excluding the impact of the Alberta fires," Avery Shenfeld, chief economist with Canadian Imperial Bank of Commerce, said in a note.

Because of Canada's reliance on the U.S. economy to spur exports, "the clouds on the U.S. outlook … are therefore a reason to worry about an extension of Canadian Q2 softness into the second half," Mr. Shenfeld said, although he added that nobody should be hitting the panic button yet.

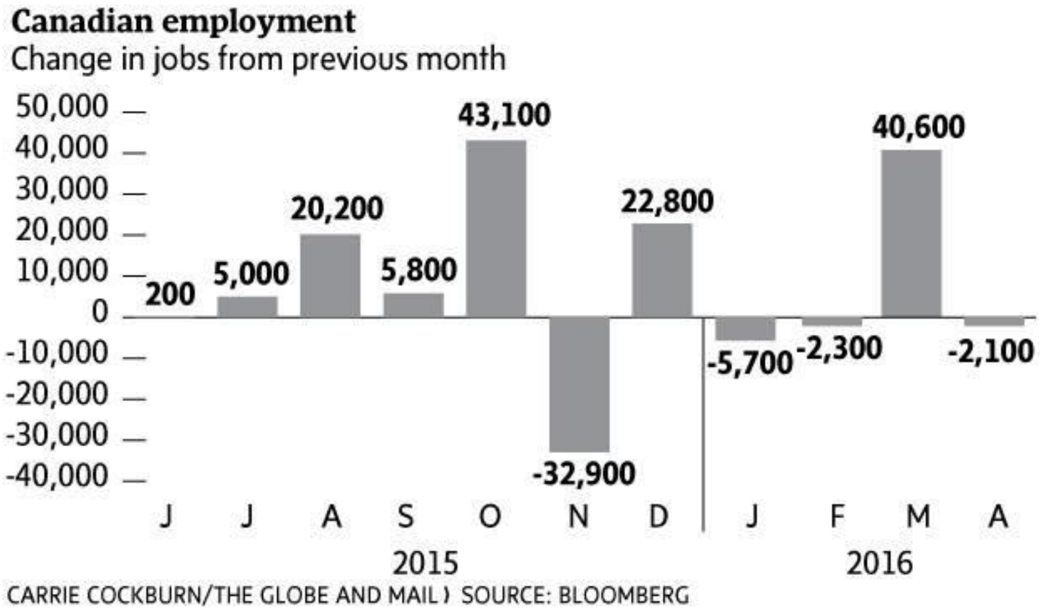
Among Canadian economic reports scheduled for release this week, Wednesday features building permits for April and housing starts for May. Housing starts have been strong so far in 2016 and "there's little indication that they're headed for a major slowdown," CIBC economist Nick Exarhos wrote.

The main economic event is Friday's Canadian employment report for May, and the numbers will depend to a large extent on how Statistics Canada treats job losses caused by the Alberta wildfires.

"The entire town [of Fort McMurray] was evacuated during the survey week and so it's likely that no households were surveyed," Bank of Montreal senior economist Benjamin Reitzes said in a note. "Whether Statscan chooses to just omit those people or estimate potential job losses will impact the headline figure significantly." Assuming Statscan excludes Fort McMurray from the survey, BMO expects an increase of 5,000 jobs in May, whereas including Fort McMurray could potentially cut employment by up to 20,000. The former scenario would leave the unemployment rate steady at 7.1 per cent, while the latter could push the rate up to 7.3 per cent, Mr. Reitzes said.

Wildfires aren't the only potential negative for Canadian employment. "The more significant source of anticipated weakness is the service sector, which has added more than 100,000 jobs in the last two months and is due for a retrenchment," Toronto-Dominion Bank economists said in a note.

TD is calling for a loss of 10,000 jobs over all in May and an unemployment rate of 7.2 per cent.



Dollarama Inc. – which holds its annual meeting and reports first-quarter results on Wednesday – has produced stellar returns for investors since it went public in October, 2009.

But is the high-flying retailer about to run out of rocket fuel?

Since its initial public offering, the shares have more than quintupled in value, generating an annualized return – excluding dividends – of more than 27 per cent. The shares now trade at a multiple of 26.8 times estimated earnings for the current fiscal year and 23.4 times next year's estimates, indicating that investors expect the chain to continue growing at a rapid rate.

But based on the stock's rich valuation, at least one analyst says Dollarama's future returns are likely to disappoint investors. ***Kathleen Wong*** at ***Veritas Investment Research*** notes that Dollarama's EBITDA (earnings before interest, taxes, depreciation and amortization) has more than tripled since its IPO. But over the same period, its multiple of enterprise value or EV (essentially market capitalization plus debt, minus cash) to forward EBITDA has expanded to 19 times from just nine times in the first year after it went public.

For Dollarama to maintain such a lofty EV/EBITDA multiple, it would likely have to repeat the past six years of growth. During that period, sales per store – based on average store counts in each year – rose at a compound annual growth rate of 3.7 per cent, ***Ms. Wong*** said. Assuming it can maintain that growth for the next six years, she estimates Dollarama's current value at $115 a share. The shares closed Friday at $91.10 on the Toronto Stock Exchange.

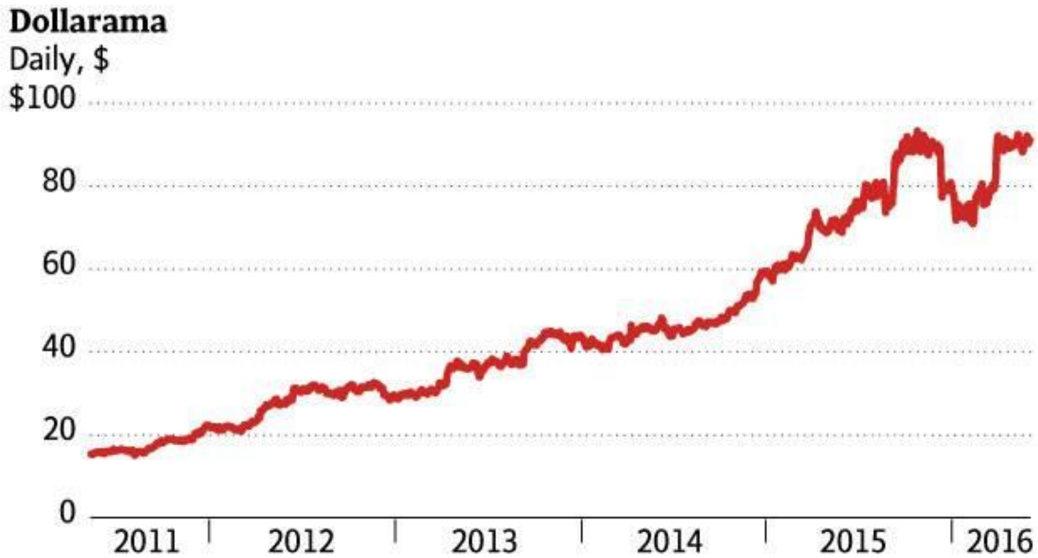
But maintaining that pace of growth is unlikely, she said, citing competition from U.S.-based Dollar Tree, growing saturation in the dollar-store market and Dollarama's reliance on price increases to fuel sales growth.

"In a more realistic case, where growth slows and the multiple contracts, we estimate Dollarama is worth $81 per share," ***Ms. Wong*** said in an April note.

For the first quarter ended May 1, analysts estimate that Dollarama will post earnings of 62 cents a share, up from 50 cents a year earlier. Should Dollarama beat estimates or post stronger-than-expected same-store sales growth, the stock could rally. It's worth pointing out that most analysts still have a "buy" rating on the shares.

However, given the stock's high valuation, there are big expectations built into the share price, and any sign of a slowdown could be severely punished.

Other retailers reporting this week include Lululemon Athletica Inc. and Sears Canada Inc., both on Wednesday, and Hudson's Bay Co. on Friday.



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DOL-T Dollarama Inc	LATEST PRICE $90.53	-0.57	(-0.63%)
LULU-Q Lululemon Athletica Inc	LATEST PRICE $67.77	+0.53	(+0.79%)
SCC-T Sears Canada Inc	LATEST PRICE $3.94	+0.03	(+0.77%)
SRSC-Q Sears Canada Inc	LATEST PRICE $3.06	+0.04	(+1.32%)
HBC-T Hudson's Bay Co	LATEST PRICE $15.41	+0.59	(+3.98%)

Updated June 6 12:06 PM EDT. Delayed by at least 15 minutes.