



Why Dollarama Inc. Could Be a Great Investment No Matter What the Market Does

Description

The Canadian economy is starting to look a little shaky.

Investors from Alberta and Saskatchewan can attest, since they're seeing evidence of it personally every day. Real estate markets in both provinces are drying up, especially in areas where energy is the main driver of the economy. Consumer spending is down as well, mostly on big ticket items. **CIBC** is even predicting that Alberta's economy will suffer a mild recession in 2015, before rebounding in 2016 along with energy prices.

The other thing that isn't really looking strong is Canada's real estate market. Sure, headline numbers are up, but that's mostly based on strength from our two largest markets—Toronto and Vancouver. In January, prices actually declined in eight of Canada's largest 11 cities. Alberta led the decline, but prices have also declined 5% in Montreal in the last seven months, and Halifax's real estate is down 5.5% in the last five months.

If both of these issues continue to persist, it'll be difficult for the Canadian economy to do much more than deliver tepid growth. Consumer confidence will plunge, and it won't just be Alberta that's in danger of a recession in that scenario.

The challenge for investors is preparing their portfolio for such an economy without sacrificing potential growth now. There aren't many stocks with the potential for outperformance even during a bad economy, but I think **Dollarama Inc.** ([TSX:DOL](#)) could actually do quite well in that scenario.

Benefiting from belt tightening

There are really only two types of businesses that benefit during a time when consumers are cutting back on spending. Grocery stores are one, as people spend less on going out for meals and more on groceries. The other is the company that offers customers a cheap choice of something they need.

Dollarama fills both of these criteria.

As Canadians tighten their belts, buying things at Dollarama becomes a very viable option. Dollarama generally has much cheaper versions of many necessities we use every day, including food, cleaning supplies, and holiday decorations. Sure, the quality isn't usually up to par compared with higher-priced items, but that hardly matters during lean times. Customers become very price conscious.

The bull scenario

Let's say that Canada's economy continues to do pretty well going forward. In that scenario, how do things look for Dollarama?

Well, the company could continue its ambitious expansion plans, with expectations of 70-80 new stores in 2015. That's growth of nearly 10% annually, which makes Dollarama the highest-growing retailer of any size in Canada. Considering the woes of the rest of the sector—just look at **Target's** doomed Canadian expansion—Dollarama becomes the most attractive option, which moves the stock higher.

Plus, there's all sorts of untapped expansion potential. According to an analyst report issued last year, there's potential in the medium term for 400-700 more dollar stores in Canada, based on U.S. penetration. Over the next 10-20 years, the same analyst predicted room in the market for an additional 1,700 dollar stores.

To put that in perspective, Dollarama will likely open its 1,000th store sometime in 2016. There's still a lot of untapped growth ahead, and its largest competitor only has approximately 200 stores.

Dollarama has become so entrenched that major food manufacturers are making specialty sized products that only sell at the chain's stores. Frito-Lay has special-sized bags of potato chips that sell for a loonie and toonie, and that's just the tip of the iceberg.

One slight issue is valuation. Investors are paying a steep price for this growth. After the recent share split, shares currently trade hands for \$63 each. Analysts project the company's fiscal 2016 earnings to come in at \$2.47 per share, for a forward P/E ratio of 25.5. That's expensive, no matter how you slice it.

But considering the growth potential ahead, Dollarama could easily grow into that valuation. And unlike just about every other stock out there, there's a realistic path for it to get there no matter what the economy does. It's one expensive stock that could actually outperform in a bear market.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TGT (Target Corporation)
2. TSX:DOL (Dollarama Inc.)

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