Is Dollarama Inc. About to Break Out?

Description

Dollarama Inc. (TSX:DOL) has been a terrific performer for investors over the past few years. More recently, the stock has been struggling to break through the $100 ceiling of resistance. The company is still firing on all cylinders, so it just needs a trigger, like an impressive earnings report, to send the stock flying into the triple digits.

Dollarama is one of the best retail plays in Canada. It offers growth and safety from economic downturns thanks to the nature of its business.

How could dollar store be a source of growth? The Canadian dollar store market is quite fragmented, and there's a huge opportunity for Dollarama to expand. The management team knows how to drive traffic to its stores, and it's a reason why same-store sales have been going up.

Customers know that they'll get good deals on necessities, and they don't have to worry about breaking the bank because Dollarama's items are currently capped at $4. Many other dollar stores have a much higher cap, and you can't really blame them because margins are quite thin in this industry, especially if the loonie continues to weaken.

Is the weak loonie cause for concern?

Dollarama has a great relationship with its suppliers, so it's able to get its items for lower prices. This allows the company to offer a better value for its customers, but in the end, a weak dollar is going to hurt margins unless the price cap is adjusted accordingly. I don't think the flock of customers will look elsewhere if the company raises its price cap because these loyal customers already know they're getting a top-notch deal on some of the highest-quality items that money can buy for a buck or two.

Dollarama has a great reputation of being a company that offers decent-quality merchandise for rock-bottom prices, and this is a competitive edge that will allow the company to thrive, even if it increases prices by a small amount to adjust for a weakening currency.

Still a ton of growth potential

Dollarama currently has over 1,000 chains across Canada, but the management team stated that it would be able to support over 1,400 chains and is aiming to get to this level going forward. Investors don't need to worry about saturating the market because there is still a ton of room to grow, and the dollar store market isn't even close to being consolidated.

The stock will also do well in the event of an economic downturn because of the incredible value offered in its stores. I'd expect to see even more customers flocking to Dollarama during a recession because everyone will be looking to save money on necessities.

We're in the late stages of a bull market, and we could see some major downside over the next few years, so it makes sense to load up on names like Dollarama before things start getting ugly.

What about value?

Dollarama isn't cheap at a 28.62 price-to-earnings multiple. Although the company is fantastic, and there's still a lot of growth, there's quite a premium on shares right now. A lower loonie definitely isn't helping the company's margins, and a huge reason why the stock has been flat is because of the unattractive valuation.

I'd wait for a pullback before considering picking up shares. The dividend yield is quite small at 0.4%, but it's worth noting that the company is well positioned to offer generous dividend raises between 12% and 15% over the next few years. I suspect the stock will continue to remain flat, at least until the earnings can catch up with the sky-high stock price. Be on the lookout for dips and pick up shares on weakness.

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