Let's Face it: Dollarama Inc. (TSX:DOL) Is Still Priced as a Growth Stock

Description

Dollarama (TSX:DOL) has been one of the most successful stocks on the TSX for years. The company delivered quarter after quarter, driving up the valuation of the discount retailer significantly. But as is often the case with stocks that have lofty expectations built in, one stumble and the stock took a tumble.

What a fall it was. After reporting its second-quarter earnings, the stock fell from around $52 a share to its current price of just over $42 — a drop of around 20%. Expectations played a huge role with Dollarama's shareholders, and once those expectations were missed there was nowhere to go but down.

But let's get this straight: Dollarama did not have a bad quarter. It simply had a quarter that did not meet many investors' lofty expectations. In fact, overall, the company is doing quite well. Sales, for one, increased by a respectable 6.9%. EBITDA grew by a healthy 7.9% and operating income grew by 7.7%. None of the numbers the company presented were particularly bad; they just weren't as great as was expected.

If this isn't a lesson in the dangers of owning expensive stocks, I don't know what is. When we invest in growth stocks, we believe that either the stock is never going to come down, or that we will somehow have the foresight to get out before the rest of the market. Unfortunately, it seems that exactly the opposite is true and we end up getting caught in the downdraft with everyone else.

Dollarama is still an excellent business. A long-term investor could probably use this downturn as an entry point to begin establishing a position. Keep in mind, though, that this stock, even after this spectacular drop, is not cheap. It is still trading at around 26 times earnings, so it should still be considered a growth stock. That means if there is any more bad news ahead, the stock could potentially be under further pressure.

This stock is definitely still one more suitable for growth investors. While it does have a dividend, that dividend is not extremely exciting yet for yield-focused investors. Dollarama currently yields only 0.37% at the current stock price — not exactly a stunning level of income at the present price. But the yield is very secure, so that would give investors some comfort. Dollarama has also hiked its dividend steadily, with the last dividend increase of 9% occurring in March. The company's payout ratio is very low, which could mean more dividend hikes in the future.

One reason that Dollarama might be a good purchase now, in spite of the still-high valuation, is the fact that this is a company that may actually benefit from a recession if one were to occur. Its low-cost items tend to be highly sought after when money is tight, so owning Dollarama may insulate investors from an economic downturn. But whether you have invested in Dollarama or another growth stock just like it, remember: it is highly likely that you will not get out at the peak. Protect yourself by setting a limit order or a stop loss and raise the stop loss as the stock increases in value. This will help to protect you if the market begins to turn against you.

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