Can This Top Canadian Growth Stock Rebound?

Description

Investing in growth stocks has been a popular trade over the past decade as investors picked high-flying technology stocks which, through the power of internet, introduced new ways of doing things.

But that strategy also has its downside. As investors get used to seeing high-octane growth numbers quarter after quarter, any slippage in expectations can produce a powerful negative impact, as the high P/Es of growth stocks build in big expectations and leave little room for error.

That's what exactly happened with Dollarama Inc. (TSX:DOL), one of Canada's top growth stocks that delivered magical return until this June when tide began to turn against this discount retailer and growth hit the ceiling.

Dollarama stock has lost more than 40% of its value from the 52-week high, as it produced dismal growth numbers in in the past two quarterly reports. Its shares plunged 17% on September 13 – their worst one-day rout – after the retailer reported quarterly same-store sales growth of 2.6% that was half of what analysts had expected.

The company attributed the weak results to a tough comparison with a year earlier and a decision to limit price increases, but skeptics believe that the retailer has peaked in its current growth cycle.

Just to provide you with some perspective, Dollarama has a dominant position in Canada's discount space. With a massive spending spree on its expansion during the past five years, Dollarama has more than 1,100 stores — a huge jump from the 700 stores it was managing in 2012.

This expansion produced great results for Dollarama's shareholders, who saw their investments surge more than three-fold, as sales grew at a compound annual growth rate of 12% since 2014, more than doubling the company's bottom-line profitability.

Is the time right to buy DOL stock?

According to some critics, including U.S. short-seller Spruce Point Capital Management, Dollarama margins are "unsustainable" and its store expansion plans "unrealistic." The main point of their bearish case is that Dollarama is no more a dollar store after the price increases that have left few items in the store actually costing a dollar.

That argument has its merits, but I believe that problem isn't unique to Dollarama at a time when many retailers are facing cost pressures, rising wages and U.S.-China trade war. Dollarama, with its dominant position in Canada, will rebound once the macro environment improves and cost pressures wane over time.

I see the current share price drop is an overreaction. In Canada, there is a growing evidence that customers accept items in $3.50-$4 price range, giving management the ability to increase prices and achieve longer-term same-store sales growth of 4%-5%.

Trading at $33.22 and with a robust dividend-growth program, Dollarama can prove a productive long-term investment. That said, investors should wait on the sidelines for a better bargain as I see more downside before the stock begins its upward move.

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