Left for Dead, One of Canada's Most Successful IPOs Is Making a Comeback

Description

What a difference a year makes. Up until 2018, **Dollarama** (TSX:DOL) could do no wrong. The discount retailer announced its initial public offering (IPO) back in 2009 and was listed on the **TSX** later that fall.

Fresh off the financial crisis, Dollarama became one of the most successful IPOs of the past decade. At its peak, the company returned a whopping 1,700%. To put that into perspective, a $10,000 investment in Dollarama back when it was first listed would have been worth $117,000.

Then the cracks began to appear. Dollarama was priced as high-growth stock and unfortunately, it could not maintain its expected growth rates. It missed on earnings' estimates several times and guided downward. Increasing competition from global players entering the market was also putting increasing pressure on its razor-thin margins.

Not even a stock split could help the company. Dollarama's stock began a slow and steady downward trend in January of 2018 before bottoming out at around $30 this past December. It had lost approximately 50% over the course of its downtrend and was quickly becoming an afterthought.

One of 2019's top stocks

This year has been a different story as Canada's poster-child for successful IPOs has realized a 55% gain in 2019, making it one of the top- performing Canadian stocks of the year.

So what changed? For starters, investors could no longer ignore Dollarama's cheap valuations. Although it did not deserve to trade in line with historical averages, the pendulum swung too far. Its forward P/E dropped to the mid-teens despite double-digit growth rates, leading to a PEG ratio below one — the first time in its history it had been that cheap.

The company trades like a momentum stock. That is, when there is bearish momentum, investors exit the stock at a rapid pace. On the flip side, when it has bullish momentum, investors pile into the stock like it's going out of style.

Case in point: Dollarama is now trading at forward price of 22 times earnings and at a PEG ratio of 2.22, neither of which are particularly cheap, especially when one considers that the company is expected to grow its earnings by only 12% on average over the past five years.

Aside from valuation, another positive catalyst was acquiring a majority stake in Dollarcity, a Latin American discount retailer. Expanding beyond its domestic market is a key growth strategy. The option to purchase a majority stake in Dollarcity was part of a partnership dating back to 2013.

The general consensus is that Dollarama acquired the stake at very attractive multiples. Dollarcity has plans to more than triple its store count over the next 10 years.

Where do investors go from here?

Despite some very positive news, the company is now fully valued thanks to its recent run-up. Outside of valuation, nothing has really changed domestically. This is still a highly competitive, low margin market. Dollarama is also still facing stiff competition from Walmart and Dollartree. Likewise, Asian discount retailers Miniso and Ximivogue have aggressive build-out strategies and are direct competitors that could steal away market share.

As of writing, Dollarama has returned 1,500% since its IPO, which is equal to a compound annual growth rate of approximately 150%. Although it has been one of Canada's most successful IPOs, don't expect anything near this type of growth moving forward.

The stock is highly volatile and investors need to pay attention to valuation. Momentum can quickly turn, and you don't want to be left holding the bag.

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