Why Dollarama (TSX:DOL) Stock Is a Buy Right Now

Description

Shares of **Dollarama** (TSX:DOL) have staged a strong comeback this year. Dollarama stock has gained over 50% year to date. So, will the stock continue to rise in the second half of 2019 or is it due for a correction? Though Dollarama shares have easily beaten peers and the broader markets in 2019, it has just recovered the losses sustained last year.

Dollarama was trading at $56.43 per share back in January 2018 and then lost significant value to trade at $32 per share by the end of 2018. Shares of this deep-discount retailer are back in demand after a minor setback, and the stock is trading close to its all-time high.

Is Dollarama's upward rally sustainable?

Dollarama is a leading domestic retailer. The company's sales growth is set to accelerate going forward. In fiscal 2019 (year ended in February), Dollarama's revenue rose 8.7% year over year to $3.55 billion. Sales are now estimated to grow by 6.9% to $3.79 billion in 2020 and by 7.5% to $4.08 billion in 2021.

This acceleration will also help Dollarama expand profit margins and increase operating leverage. Its earnings per share are estimated to rise at a compound annual growth rate of 11.8% in the next five years. The stock is trading at a forward P/E multiple of 22.8, which might suggest that the stock is overvalued at the current price. But investors don't mind paying a premium for stable growth stocks, and Dollarama's growth story is far from over.

What will impact Dollarama's revenue growth?

Dollarama stock has generated massive investor wealth, despite the pullback experienced in 2018. The stock is up 225% in the last five years, easily outpacing market returns. This growth was supported by robust revenue growth when the company opened stores across the country at a massive rate. The period between 2010 and 2018 was colossal for Dollarama and investors. The company grew revenue at an annual rate of 12.8%, while earnings rose by 28% in that period.

Dollarama increased net margins from 5% in 2010 to 15% in 2018.

Now, Dollarama is opening new stores at a lower rate. The transition towards e-commerce might also impact sales. Dollarama has positioned itself as a “dollar store” and has a loyal customer base. It needs to ensure that product prices do not rise significantly or it will negatively impact store traffic. While Dollarama has introduced higher-priced products, it continues to focus on low-priced items and drive sales growth.

What’s the verdict?

Dollarama has a solid business model in place. It has just over 1,200 stores, and this might rise to 1,700 by the end of 2027. Its recent acquisition of a controlling stake in Dollar City will add between $0.02 and $0.03 in per-share earnings this year. This acquisition is expected to add between $0.05 and $0.07 to the bottom line next year, indicating an incremental earnings growth of 4% year over year.

Dollar City will also increase its Latin America store count from 180 to 600, which will continue to push revenue higher. The Latin America region is far more densely populated compared to Canada and will result in a massive customer base for the company. While the purchasing power is significantly higher in Canada, this acquisition will help Dollarama gain traction in international markets.

But the most important factor for Dollarama investors is the threat of a looming recession. We are in the midst of one of the largest bull runs in stock market history. While no one can accurately predict when the next economic downturn will hit us, it is going to be sooner rather than later. Discount retailers generally outperform markets during an economic slowdown, making Dollarama a solid bet for the long term.

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