Canadians: Should You Buy Dollarama (TSX:DOL) Before Earnings on December 5?

Description

Dollarama (TSX:DOL) has posted a remarkable comeback in 2019 after shares fell 45% from peak to trough over slowed growth concerns sparked by a sub-par quarter delivered in the year prior.

When Dollarama stock was around its all-time high, I'd warned investors that the stock was due for a crash, citing rising competitive pressures, limited room for further expansion in Canada, the stock's severe overvaluation, and changing brick-and-mortar trends as reasons to sell the stock.

Fast forward to today, and growth concerns appear to be shelved (at least partially) with the stock now commanding a 28 times trailing earnings multiple.

A solution to Dollarama's slowed growth?

While Dollarama has unlocked a new growth outlet with a 50.1% interest in Latin American discount retailer Dollarcity, investors need to remain cautious, since the success that Dollarama had with its Canadian expansion is no guarantee of success in an emerging market, which may be subject to more volatility. Moreover, margins may be thinner in Latin America, and due to the riskier nature of operating in an emerging market, Dollarama's defensive characteristics could be at risk of diluting with time.

Fortunately, Dollarama isn't jumping headfirst into the deep end with its partial, albeit majority, stake in Dollarcity. And while there's encouraging growth potential in Dollarcity, there's also a higher degree of operational risk, so the stock may not deserve the +30 times earnings multiple that it commanded in the past.

Earnings could make or break the stock

The company delivered a mixed Q2 fiscal 2020 earnings report, and with Q3 2020 earnings on tap for December 4, many investors may be wondering if shares of the Canadian discount retailer can post a complete rebound and break above its early 2018 all-time highs.

Same-store sales growth (SSSG) numbers for Q2 were encouraging, but I warned investors that strong SSSG trends would likely continue to be at the expense of margins and would urge investors to look for gross margins to trend upwards in conjunction with SSSG numbers before paying up for a name that I still think is at risk of another substantial correction.

Should you buy Dollarama before its December 4th earnings?

The stock currently trades at 19 times forward earnings, which is not a ridiculous multiple to pay for a firm that's grown its top and bottom line by double digits over the past three years.

What bothers me most, though, are the competitive headwinds that could continue to weigh on the stock over the next year or so. As such, I can't say I'm a massive fan of the risk/reward and would encourage investors to wait for a better entry point (in the low-$40s), which may present itself before the year concludes.

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