Dollarama (TSX:DOL) Stock: Should You Buy on the Pullback?

Description

Dollarama (TSX:DOL) stock has corrected more than 20% from the 2018 levels. Is it time to buy the growth stock?

Investors must focus on paying a good value for the stock. Because Dollarama stock's dividend yield of 0.4% is minuscule, shareholders must draw value from price appreciation.

A recession-resilient stock suspect

Dollarama had its initial public offering after the last recession in 2008-2009 ended. So, we don't know how it might perform during that recession.

However, we can look at the performance of its North American peer, **Dollar Tree**, as a close example. Dollartree's earnings per share essentially stayed flat or grew during the last two recessions.

Therefore, we can also guess that Dollarama's business performance will also show resilience during a recession, seeing as both companies have similar business models.

Specifically, Dollarama is a value retailer that offers a broad variety of consumable products, general merchandise, and seasonal items both in-store and online to attract repeat visits from consumers. It has about 1,300 locations across Canada in metropolitan areas, mid-sized cities, as well as small towns.

Dollarama has multiple growth drivers, including an increasing net store count and same-store sales growth. However, the company also needs to keep its margins stable (if not growing).

Notably, profitability remaining intact is different from the stock price staying intact.

During the last two recessions, Dollar Tree stock experienced valuation contraction that pulled the stock down about 40% both times from a pre-recession peak to a recession low.

The smart investor would have taken advantage of the valuation contraction and loaded up on the stock.

Dollarama is a cash machine

In the past few years, Dollarama generated substantial operating cash flow of more than $500 million per year and only used less than 29% for capital spending. This resulted in gushing free cash flow generation that averaged close to $400 million per year.

Valuation and dividend growth

At $41.62 per share at writing, Dollarama stock trades at about 23.4 times earnings, while it's estimated to increase earnings per share by 10-11% per year over the next few years. So, it's a decent valuation to buy some shares.

Although Dollarama stock offers a tiny yield, it has been increasing its dividend at a high pace. Accordingly, investors should view it as a growth stock that pays a growing dividend. Its five-year dividend-growth rate is about 11% per year.

Going forward, the growth stock will have no problem increasing its dividend by 10% annually if not higher. Its earnings are expected to grow at that pace. Additionally, its payout ratio is very low at about 10%.

Investor takeaway

Dollarama is the kind of business that's recession proof, meaning that its earnings should remain stable if not growing when there's an economic downturn.

According to its usual schedule, Dollarama would be reporting its fiscal Q4 and full-year 2020 results in late March. So, interested investors can view the stock pullback as a good opportunity to buy some shares for long-term investment and to consider adding to the position after the report gives more clarity about the future outlook of the company.

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