Why Dollarama Stock (TSX:DOL) Is a Top Pick for 2020

Description

The economic uncertainty caused by the coronavirus pandemic has destroyed the growth prospects for many companies. Canada's largest discount retailer **Dollarama Inc.** (TSX:DOL) is certainly not immune from this shock.

In the latest earnings report released last week, Dollarama provided a mixed picture about its future prospects as it tries to adjust its business for the post-virus economy.

The Montreal-based discount store chain has felt a dual effect on sales as a result of the pandemic. Earlier, it saw a rush of purchases as people stocked up on essential items, such as cleaning products and canned goods. But store traffic contracted more recently as people stayed home in an effort to prevent the spread of the virus.

"The strong momentum of the fourth quarter carried over into early fiscal 2021 and then we experienced a surge in transactions as customers stocked up on everyday essentials due to COVID-19. This was followed by lower traffic as a result of public health measures directing Canadians to stay home as much as possible," Dollarama said in an earning statement last week.

Going forward, the big question lurking in the minds of investors is whether this retailer can continue with this strong performance, especially when the economy is slipping into a recession, forcing consumers to cut back on their spending.

Resurgence in sales

In my view, Dollarama is well positioned to sustain a severe blow to the economy. First, CEO Neil Rossy has been tweaking his merchandising tactics to keep attracting customers amid a general stall in price inflation in the marketplace.

Just before going into the coronavirus-triggered shock, Dollarama was in control of its destiny, posting strong growth in same-store sales.

Comparable store sales grew 2% in the fourth quarter that ended in February, or 3.8% excluding the impact of the calendar shift, over and above a 2.6% growth for the same period in the previous year.

Comparable store sales rose 4.3% in the past fiscal year compared with a 2.7% growth in fiscal 2019.

Dollarama's decision to open new stores helped fuel growth in the past fiscal year. The chain opened 20 net new locations in the fourth quarter and 66 net new stores over the course of its fiscal year.

The company reported net earnings of $178.7-million, or $0.57 per share in the fourth quarter, up from $171-million or $0.54 per share in the prior year.

Second, discount retailers, such as Dollarama, perform better in a recession, as while cutting back spending on vacations and other luxury items, consumers are highly unlikely to stop buying low-priced, daily-use items, such as storage containers and back-to-school supplies.

For investors who want to hold a quality retailer in their portfolio, Dollarama is certainly a name to add. Its consumer proposition is solid, and its business model is one of the most financially productive.

This position has been further strengthened after the chain bought a 50.1% stake in rapidly growing Latin American value retailer Dollarcity last year.

Bottom line

Discount retailers generally perform well when the economy slows down and the threat of recession rises. With this backdrop in mind, it's a good time to buy Dollarama stock, especially after its 11% plunge in the past three months.

Trading around $40.88 a share at writing, this stock is still offering a good value to long-term investors.

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