Dollarama (TSX:DOL) Just Became a Must-Buy at $42

Description

Dollamara (TSX:DOL) is the perfect example of a stock you'd want to buy as we head into a recession. The stock was quick to recover from the coronavirus-induced crash and is actually slightly above where it was before the broader markets fell off a cliff on February 20. That said, Dollarama was already in a world of pain before the pandemic gripped the **TSX Index**.

What a roller-coaster ride it's been for Dollarama stock

Over the last few years, Dollarama stock has been a roller-coaster ride, with shares plunging 45% from peak to trough in 2018, only to recover partially and fall again by 32% between mid-2019 and early 2020. The former market darling has not been for the faint of heart. To put it simply, the company has been a victim of its own past success, as it's proved to be a challenge for the company to sustain its double-digit growth rate.

Dollarama stock has suffered a painful reset to expectations and, with that, some serious multiple compression. If Dollarama doesn't have the growth runway it used to, the stock simply isn't worth north of 30 times trailing earnings. That said, Dollarama has taken steps to improve its longer-term growth profile through its majority (50.1%) stake in Latin American discount retailer Dollar City.

Such an expedition into a new market could give Dollarama the growth resurgence to regain its former status as a growth king that would warrant the +30 P/E multiple it's held in the past. Given success is no guarantee in uncharted waters, though, I wouldn't be so quick to back up the truck with the belief that the name will enjoy an abrupt upside reset to expectations anytime soon given that Dollarama's Latin American expedition is unlikely to be a needle mover over the intermediate term.

Where does Dollarama stock go from here?

Dollarama has a tough task on its hands in the Canadian market. It can bolster same-store sales growth (SSSG), but doing so would likely cause margins to erode, especially with the pressures facing the loonie. Moreover, it naturally becomes harder to stay on the "growth treadmill" over prolonged periods of time without sacrificing some return on invested capital (ROIC) numbers. In any case, there is no easy solution to Dollarama's growth woes.

As the pandemic propels us into a recession, though, I see Dollarama enjoying a nice boost, as Canadians look to make every dollar go further when it comes time to really tighten the belt. As a defensive growth stock, Dollarama is a rare breed, indeed. And it deserves a premium multiple, but probably not north of 30 times earnings.

Given the bleak economic outlook, Dollarama could prove to be a bargain with shares trading at a mere 3.5 times sales and 14.6 times EV/EBITDA. The discount retailer may have run itself off the growth treadmill, but that's not to say it can't experience a growth resurgence as it slowly but steadily expands into new promising new markets.

Foolish takeaway

Fundamentally speaking, Dollarama is a buy given the looming recession, despite the company-specific challenges that lie ahead. And from a technical standpoint, a reverse head-and-shoulders pattern appears to have formed, and that bodes well for Dollarama stock over the near term. As such, I see Dollarama stock as one of the timelier bets on the TSX today.

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Date
2025/08/23
Date Created
2020/04/16
Author
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