



Has the COVID-19 Outbreak Made Dollarama Stock Too Risky to Buy?

Description

Dollarama ([TSX:DOL](#)) is one of a few companies that have pleasantly surprised investors with over 1,000% positive return in the last decade. That makes it one of [the most attractive retail](#) companies to invest in — arguably better than American giant **Amazon**. By comparison, the **S&P/TSX Composite Index** has gone up by only about 45%. Except in 2018 — when some analysts and short-sellers pointed towards the company's slowing sales growth rate — it has yielded positive returns every year since its initial public offering in 2009.

As of June 5, 2020, Dollarama stock has gone up by 6.8% year to date as compared to a 7.1% drop in the TSX Composite Index. The ongoing global pandemic has taken a big toll on investors' sentiments this year — resulting in a sharp stock market sell-off across the globe. Now, let's take a look at how the pandemic has had an impact on Dollarama's business so far and whether or not it has made it a risky investment.

Accessing COVID-19's impact on Dollarama's business

The COVID-19 outbreak forced many businesses to close their stores, except for essential ones. Soon after Prime Minister Justin Trudeau announced a nationwide closure of nonessential commercial activities in March, Dollarama was [recognized as an essential business](#). The formal recognition allowed the company to keep most of its stores open.

In early April, Dollarama said that only 54 out of 1,291 its total stores were temporarily closed. And most of these stores were located in Quebec shopping malls. Also, it has seen a positive sales trend for certain essential goods, such as household cleaning products, health and hygiene products, and food items, as consumers started stocking up. Nonetheless, this positive sales trend only lasted for a few weeks in late February to mid-March.

So, it is difficult to say whether these trends could boost Dollarama's total sales in the first quarter of fiscal 2021. These uncertainties forced the company's management to suspend its first-quarter guidance.

What makes Dollarama stock risky?

Dollarama is set to release its Q1 results on Wednesday this week. While the company saw an improvement in its sales for the first few weeks of the quarter, it expected its same-store sales to be negative for the remainder of the quarter.

Note that Dollarama's focus on its store chain expansion has been one of the key contributing factors to its sales growth. In the fiscal year ended February 2, 2020, the company opened 66 net new stores, slightly lower from 65 net new stores opened in fiscal 2019.

The restrictions due to COVID-19 outbreak is likely to halt its store expansion plans in fiscal 2021.

Dollarama acquired a 50.1% stake in Latin American discount retailer Dollarcity in August 2019. However, the pandemic has forced Dollarama to exclude Dollarcity's contribution to its earnings per share for fiscal 2021. Strict lockdowns in Guatemala and Colombia — among other regions — forced Dollarcity to temporarily close its 38 out of 228 stores.

Foolish takeaway

The ongoing pandemic boosted Dollarama's essential items sales for a few weeks. However, the short-lived sales trend might not be enough to justify a recent notable rally in its stock price. In the last three months, the company's stock has inched up by 20.4%, as compared to a 4.2% drop in the TSX Composite benchmark.

At the same time, factors hurting Dollarama's store expansion plans could be temporary. While they will affect the company's sales growth in the near term, it might try to pursue these expansion plans more aggressively after the restrictions due to the COVID-19 outbreak are over.

On the one hand, COVID-19 might not affect Dollarama's long-term growth potential. On the other hand, it's very likely to hurt its sales growth in the near term. This would make me want to avoid buying the company's stock at current levels when it has already risen sharply, despite all the uncertainties that we discussed.

CATEGORY

1. Coronavirus
2. Investing

TICKERS GLOBAL

1. TSX:DOL (Dollarama Inc.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Coronavirus
2. Investing

Date

2025/08/26

Date Created

2020/06/09

Author

jparashar

default watermark

default watermark