Forget the Naysayers: 3 Top Retail Stocks You Should Own

Description

Many investors simply refuse to own retail stocks, because they worry about the myriad issues that can impact the sector.

I've long considered retail to be one of the toughest sectors in the entire market. There's little to differentiate one player from the next, especially in hyper-competitive sectors like clothing, grocery, or general merchandise. Price ultimately wins out — a race to the bottom that isn't good for anyone's margins.

And then there's the increase in online sales. Online-only retailers don't have expenses like storefronts or advertising budgets. That translates into lower prices many traditional retail stocks just can't compete with. In fact, many consumers use retail space as a way to touch and see the product, and then they use that information to get a better deal online.

But it's not all doom and gloom for retail stocks. There are a select few that are excellent operators — the kinds of companies that have carved out a nice little niche market. Let's take a closer look at three such names here in Canada — the kinds of stocks even retail skeptics like me are interested in owning.

Dollarama

Dollarama (TSX:DOL) has a genius business model. By limiting the size of its stores, it can pick and choose the items it carries. If something can't be sold for the desired margin, its buyers simply don't bring it in.

The company still has loads of growth potential, too. It has approximately 1,200 stores here in Canada with room for hundreds more. It also has an investment in Dollarcity, a chain of dollar stores in Central America. There are approximately 200 Dollarcity stores today; the company has a goal of having 600 stores by 2029.

This long-term strategy has translated into absolutely wonderful long-term returns. A $10,000 investment in this retail stock a decade ago is now worth $116,032, assuming all dividends were reinvested. That translates into a 27.77% annual return. You won't find many better results.

The next decade probably won't be as good. But Dollarama still has tonnes of potential behind it.

Couche-Tard

Alimentation Couche-Tard (TSX:ATD.B) is a different kind of growth stock. Rather than growing organically, the convenience store chain is acquiring its way to glory. After dozens of deals over the last few decades, it now boasts a network of nearly 15,000 stores across the world if we include international licences. Most of the company's sales come from Canada, the United States, and select European markets.

This retail stock still has plenty of expansion potential, too. It has a mere 5% of market share in the United States, its largest market. There are still numerous convenience chains here in Canada that could sell to Couche-Tard, too. The company also planned an acquisition in Australia before COVID shut that down. Look for it to go back to the land down under once the world returns to normal.

Shares trade at just under 18 times trailing earnings, which is a solid valuation for a stock with such strong growth potential. Investors also get paid a small dividend as they wait.

Metro

Many major grocery chains are real estate companies in disguise. Rather than own its stores, **Metro** (TSX:MRU) has adopted a different model — one that depends on leasing the vast majority of its locations. This allows it to grow quicker than its peers; it also needs less capital to expand.

2019 was a big year for Canada's third-largest grocery stock. It finally made good on its long-term potential to acquire Jean Coutu Group, which saw it add 650 pharmacies to its fleet of 950 grocery stores. Results from the acquisition have already been good with the pharmacy chain reporting a same-store sales increase of 2.4% in 2019.

Overall, this strategy has led to an excellent return on equity. In 2019, Metro's return on equity exceeded 12% for the 27th consecutive year. The company also has an impressive streak of dividend growth with 2019 marking the 25th consecutive year of growing the payout. The current yield is 1.6%.

The bottom line

Don't believe the naysayers. Solid retail stocks like Dollarama, Couche-Tard, and Metro can still be a part of a diverse portfolio. In fact, these growth stories still have loads of potential to boost your own bottom line.

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nelsonpsmith