



Dollarama (TSX:DOL) Stock: Overdue for Another Big Plunge?

Description

What a roller-coaster ride of a stock **Dollarama** ([TSX:DOL](#)) has been over the years. As you may remember, I [called the initial plunge in shares of Dollarama](#) with impeccable timing back in January 2018, when the stock was in the midst of its seemingly unstoppable bull market.

Dollarama stock: Pretty volatile ... for a defensive!

I wrote that Dollarama stock was not worth the high price of admission and outlined various growth headwinds that would likely pave the way for some serious multiple compression, as the growth darling evolved into more of a stalwart.

“Dollarama sells cheap items in its stores, but the stock is anything but cheap right now. I’m also not a big fan of management’s share repurchases, as I think the stock has been overvalued for quite some time now.” I said. “If you’re keen on investing in a defensive growth stock like Dollarama, I’d recommend waiting for a pullback or a longer period of stock price consolidation, which will give earnings a chance to catch up.”

Fast forward to today, nearly three years later, and the stock is right where it was before I rang the alarm bell on the name. The path back to \$51 and change turned out not to be a consolidation channel but a wild swing that included two vicious plunges in excess of 30%. With the stock looking to test the long-term ceiling of resistance in the mid-\$50s once again, I think Dollarama is at high risk of suffering another one of its vicious declines.

Did Dollarama stock overshoot to the upside again?

Although Dollarama is a great recession- and pandemic-resilient name to hold in the face of a worsening pandemic, my personal financial models show that the valuation has, once again, gotten ahead of itself. Dollarama stock has surged 45% since its lows in March, and in the face of [the next market-wide sell-off](#), I don't think shares will be able to hold their own, as investors look to take profits on a stock that's way too frothy.

Now, I am optimistic that the firm can regain its growth edge with Dollar City. But in the meantime, I'm skeptical over the company's ability to sustain its incredible operating margins, especially if international discount retailers were to cut into Dollarama's turf, hungry for a slice of its economic profits.

Dollarama's margins have been ridiculously impressive over the years. Although there has been no evidence of a significant margin downtrend yet, I would brace for longer-term margin erosion ahead of time, as offering a solid value proposition may no longer be enough if the Canadian discount retail scene were to face increased competition over the next decade. If competition heats up, not only will Dollarama need to have the best deals in town, but it'll also need a robust digital presence and an upgraded in-store experience that doesn't include stacks of cardboard boxes. All such competitive efforts could take a toll on operating margins over the long term.

Over the near to medium term, Dollarama stock looks in a great position to experience reasonable growth amid the coronavirus recession, as Canadians look to tighten the belt. Moreover, margins should remain robust for the duration of this pandemic, as I don't see competition heating up anytime soon. My major concern with Dollarama stock over the near term is its valuation. At around 30 times trailing earnings, I believe, are unreasonably high.

Foolish takeaway

Dollarama is a terrific defensive growth company. But at these heights, I'd prefer sitting on the sidelines in case DOL stock suffers another one of its big reversals. If shares do experience another bear market moment, I'd look to load up on shares, as the name could find itself stuck in its wide consolidation channel for quite a while.

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