



Dollarama (TSX:DOL) Just Plunged 12%: Time to Back Up the Truck?

Description

Shares of the top Canadian discount retailer **Dollarama** ([TSX:DOL](#)) just nosedived over 12%, as it felt the full impact of the correction in the broader markets. The steep October market sell-off didn't seem to spare the defensives. Dollarama seemed to get dinged far worse than the average defensive, likely because the stock was pretty darned expensive versus the likes of many of its peers in the defensive retail scene.

A dire warning

It was a very steep decline, but my Foolish followers can't say they weren't warned about the correction in shares of Dollarama, though, as I've been warning that the name was overdue for a [vicious technical correction](#) that would bring its frothy valuation right back to Earth.

"My major concern with Dollarama stock over the near term is its valuation. At around 30 times trailing earnings, I believe, [Dollarama's valuation] is unreasonably high." I wrote in a prior piece just a day before Dollarama cratered. "Dollarama [may be] 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, as the name could find itself stuck in its wide consolidation channel for quite a while."

Talk about impeccable timing with my sell call. As you may remember, I also [called Dollarama's initial violent pullback](#) while shares were hovering close to all-time highs back in 2018 in a piece titled "Dollarama Is Not Worth the High Price of Admission."

Now that the band-aid has been ripped off and Dollarama is between correction territory and a bear market, should investors seeking recession- and COVID-resilient plays be looking to accumulate shares with third-quarter earnings on tap in the first week of December? Or could the name have further to fall, as a part of an "everything sell-off" that could span most of November, as investors digest the U.S. election results?

Has Dollarama stock fallen too hard, too fast?

There's no question that Dollarama stock was a tad on the frothy side. Still, with few reasons behind the excessive decline, I think investors who are light on defensives (defensive growth in particular) may wish to scale into a position now, with the intention of averaging down on more weakness that could be ahead. The correction, I believe, is a healthy technical one, and with a nearly 13% discount to those 52-week highs, I think most of the damage has already been done, and the valuation is now pretty reasonable.

Many sell-side analysts on the Street are quite split on Dollarama, with almost an equal number of buys as holds and an average price target being pinned at around \$55 (that implies 18% from current levels, with shares at \$46 and change). With bad news on surging coronavirus cases, you'd think investors would bid up Dollarama further, but that simply wasn't the case, as this latest correction has given investors few, if any, good places to hide from the volatility storm.

Foolish takeaway on Dollarama stock

Dollarama is ready for another wave of lockdowns, and I suspect its operating cash flows will be relatively unscathed, as consumers look to load up their baskets on low-cost necessities. Dollarama is a weak buy in my books, as there's some support at around \$45 (3.5% downside from today's levels).

If you believe that a surprise U.S. election result will tank the markets below those September lows, it may be a wise idea to wait for Dollarama stock to fall further, perhaps below the \$40 mark. Personally, I'll be waiting for the name to fall to the low \$40 levels. If it does, I'll be ready to back up the truck on the misunderstood defensive growth stock.

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Date

2025/08/02

Date Created

2020/10/30

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