Dollarama (TSX:DOL) Correction: Buy the Dip?

Description

Dollarama (TSX:DOL) has been a rollercoaster ride of a stock over the years. I called the initial collapse in shares back on January 2019, as well as the October 2020 pullback that hit days after my piece was published. Now, I'm starting to change my tune on the name, as shares have fallen too fast, too hard, given the firm's low-risk growth trajectory that will be little-rattled by further waves of COVID-19 cases.

Now, I wouldn't call Dollarama stock a steal by any means at $47 and change. The stock has a track record of crumbling like a paper bag, with two severe bear market crashes (two separate peak-to-trough drops of 45% and 28%) suffered over the last two years and change. If this recent correction is just the start of something more sinister, the stock could easily find itself back in the low $40 range by year's end.

Will Dollarama's decline extend further?

Given the potential for a vicious growth-to-value rotation, Dollarama could easily get dinged further, punishing dip buyers who backed up the truck on shares on this latest correction.

Given Dollarama stock still holds a lofty high-growth multiple (shares trade at 27.2x trailing earnings at the time of writing), I suspect it'll be grouped alongside many other growth stocks that are likely to be on the receiving end if we are, in fact, poised for a return to value names.

The technical picture doesn't bode too well for shares of Dollarama either, with a bearish double-top pattern that implies this current sell-off could extend another 10-15%. Although Dollarama is one of the best recession- and pandemic-resilient names to be in a worsening of the coronavirus crisis, I'd be more inclined to wait for better prices than load up on shares at these levels.

That said, Dollarama is slightly undervalued here and would encourage investors light on defensive positionings to start scaling into a position now, with the intention of buying more shares should DOL stock be destined to fall back to $40. If you're keen on the name, it can't hurt to initiate a third of a position here as you wait for a better price to put the remaining two-thirds to work.

Just how much should Dollarama stock be worth?

Dollarama stock deserves a growth multiple, but just how much of a growth multiple is the big question. The company is well-positioned to re-accelerate its growth numbers coming out of this crisis as it looks to spread its wings into international markets. Over the long run, Dollarama will resist the move growth-darling-to-stalwart transition that'll compress DOL stock's multiples.

But in the meantime, Dollarama, like most other retailers, will be rolling with the punches that this crisis will continue to throw its way, and it's well-positioned to do so with a rock-solid balance sheet, improving gross margins, and robust free cash flow generation. While Dollarama is ripe with long-term growth options, the COVID-19 crisis puts such longer-term growth initiatives in the backseat, which could leave a bad taste in the mouths of investors.

Foolish takeaway

All in all, I think Dollarama is worth $62. But that doesn't mean shares can't revisit $40 before they blast-off to all-time highs.

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