Dollarama (TSX:DOL) Just Hit a Massive Buy Signal

Description

Dollarama (TSX:DOL) stock is picking up momentum of late amid renewed COVID-19 vaccine hopes. With shares approaching all-time highs, just days away from its third-quarter fiscal 2021 (Q3/F2021) results, I think investors should look to initiate a position before the curtain is lifted, as the stage could be set for a much-awaited breakout past those now distant January 2018 highs.

Dollarama earnings preview

Dollarama's Q3 earnings are on tap for the morning of December 9. Amid the second wave of coronavirus cases, essential discount retailers like Dollarama are likely to see more of the same: less foot traffic and larger basket sizes. The net result should be muted, but with modest analyst expectations going into the quarter, I'd say now is the time to be a buyer before earnings growth numbers have a chance to soar coming out of this pandemic.

Fellow Fool Andrew Button thinks that Dollarama stock is a tad on the pricey side heading into earnings:

> "Dollarama stock is getting very pricey. According to YCharts, the P/E ratio now sits at about 31. That's not insanely expensive, but it's the kind of P/E ratio you'd normally expect from a growth stock. And Dollarama isn't growing that quickly. If we took COVID-19 costs out of the equation, we could optimistically say that Dollarama would be growing earnings at 5-10% a year. That's the kind of growth we expect from bank stocks, and bank stocks normally don't have 30 P/E ratios."

While Dollarama had witnessed a drastic deceleration in its growth well before the pandemic struck thanks to nationwide saturation, I'm more inclined to disagree with Button in that the stock is not worthy of a "growth multiple." Moreover, the business of discount retail and banking couldn't be more different.

Dollarama: Does it deserve a growth multiple?

I'll admit, a price-to-earnings multiple north of 30 is not a low price to pay, especially for a firm that's had its fair share of growth challenges.

Back in 2018, I'd called the initial crash in shares of Dollarama, noting the firm was absurdly expensive and that the firm would not have an easy solution for the growth headwinds that threatened to compress Dollarama's rich multiple. Things are different this time around, though. Dollarama has demonstrated impeccable resilience in this pandemic. Yet it's still taken a bit of a hit, with the sanitization costs, limited hours at some locations, and drastically dampened sales for the Halloween season.

As we move into the post-COVID world, Dollarama is likely to witness a boost in its earnings, as belt-tightening Canadians look to take advantage of the discount retailer's unmatched value proposition. Recent strength in the loonie versus the greenback bodes well for Dollarama's purchasing power, given a big chunk of goods are imported.

Also, longer-term growth prospects from Dollar City should not be discounted by investors.

Once the pandemic ends, I suspect efforts to grow beyond the confines of Canada will more than justify DOL stock's premium price tag. Sure, Dollarama's growth has stalled in recent years, but that doesn't mean the company can't re-accelerate its growth back to the double digits on the other side of this pandemic, especially given promising catalysts that are just around the corner.

The Foolish takeaway

Given the magnitude of earnings growth (and, in turn, price-to-earnings compression) on the horizon, I'd say Dollarama stock isn't nearly as expensive as it looks. Given the relief that's just around the corner, I'd say shares of DOL are actually pretty darn cheap. On November 30, Irene Nattel of RBC Capital maintained her buy rating on shares of Dollarama, with a Street-high price target of $64, suggesting around 19% worth upside from today's levels.

Don't be fooled (that's a lower-case *f*) by the seemingly high price-to-earnings multiple; Dollarama stock, like the products it sells, is cheap heading into earnings. And I think the stock could break out on next week's earnings results.

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