Dollarama Stock: How High Could It Go This Year?

Description

Very few stocks consistently beat markets. Canadian discount retailer **Dollarama** (TSX:DOL) is one of them. Be it the bear or the bull market, DOL stock has consistently performed well in the past decade. It has returned 20% in the last 12 months and 740% in the last 10 years. The **TSX Composite Index** has returned -3% and 70% in the same period, respectively.

How has Dollarama managed to consistently outperform ?

Dollarama offers a wide range of merchandise at fixed price points sourced directly from low-cost vendors. Its value proposition turns all the more lucrative for value-conscious consumers amid the inflationary environment.

Many companies witnessed earnings decline and margins squeezed in the last few quarters, thanks to concerning inflation and higher interest rates. At the same time, Dollarama saw accelerated revenue growth and noteworthy margin stability, driving its outperformance last year.

Dollarama's consistent earnings growth has created massive shareholder wealth in the past. It operates more than 1,400 stores across Canada – a key competitive advantage over peers. The discount retailers expansive geographical presence helps extend its reach and fuels topline growth. Thus, it plans to continue to expand geographically and open 70 new stores every year. Dollarama aims to reach a store count of 2,000 by 2031. Note that when it comes to store count, no peer comes close to Dollarama.

Dollarama: Financial growth

The company has shown handsome financial growth over the long term, justifying its outperformance over the years. Its revenues grew by 10%, and normalized net income by 14%, compounded annually in the last 10 years. Its return on capital ratio averaged around 30%. The return on capital ratio indicates how efficiently a company allocates its capital to profitable projects. Companies with this ratio generally above 15% are considered an attractive investment.

Dollarama holds a 50.1% stake in DollarCity—the Latin American retailer. It will likely be an important growth driver for DOL in the long term. It currently has 395 stores in four Latin American countries and plans to expand to 850 by 2029.

Should you buy DOL stock?

DOL stock has come down from $86 to $78 in the last few weeks. While the stock seems to have seen some profit booking at those levels, the downside looks limited due to its business strength and earnings growth potential.

Plus, market participants also could have moved to riskier assets like tech by dumping relatively slow-growing sectors like retail. Slowing rate hikes indicates the increasing risk appetite of investors.

It is currently trading at a price-to-earnings ratio of 30x and looks expensive. This is certainly a stretched valuation compared to that of peers and its historical average. However, stable earnings growth and a solid business model make its premium valuation warranted.

A retail stock for recessionary and normal times

After back-to-back years of outperformance, DOL stock might keep trading strong in 2023 as well. Even if tech seems to steal the show for now, recession fears might keep investors on their toes. And names like Dollarama, which offers stability and moderate growth, should outperform.

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Author
vinitkularni20