After Gaining 25% in 2022, Can Dollarama Repeat in 2023?

Description

In 2022, a year when the majority of Canadian stocks lost value and the TSX was down more than 8%, it's not surprising that **Dollarama** (TSX:DOL) was one of the few stocks that gained value.

There are several reasons why the broader market sold off in 2022, including multiple headwinds impacting the economy and, consequently, the stock market.

Rapidly surging inflation was the most significant headwind, and higher inflation caused interest rates to rise. Rising interest rates are important to get inflation under control, but in the short term, it only makes spending even more expensive for consumers.

Naturally, Canadians looked for ways to stretch their dollars, and one of the easiest ways to save money is to look to discount retailers such as Dollarama.

Dollarama has a great business in that sense. There will never be a shortage of demand for consumers looking to save money, even when the economy is growing well. But it can especially see a bump in business when the economic situation worsens.

And because many of the items Dollarama sells are staples, it can pass cost increases along to consumers. Furthermore, it will have robust and consistent demand for its products.

However, with all that being said, whether it can grow another 25% in 2023 is a big ask. For a company to grow by 25% per year is significant. But if there was a stock that can do so, it would be Dollarama. After all, over the last decade, investors have earned a total return of 741%, or a compound annual growth rate of 23.7%, just shy of 25%.

Can Dollarama grow 25% again in 2023?

There is a tonne of opportunity for Dollarama stock to continue growing in 2023. First off, inflation remains high, and many still expect a recession at some point in 2023. This should continue to drive higher sales at its existing stores.

In addition, Dollarama plans to continue opening stores across the country as well as in Latin America with Dollarcity. Already Dollarama has over 1,450 stores across Canada and is on the path to reaching at least 2,000 stores by 2031.

Typically, Dollarama stores pay for themselves within two years of opening due to the incredible sales and popularity that the brand sees. It’s no surprise that even after the impressive growth we saw in 2022, analysts expect sales to grow by nearly 15% in 2023 and another 9% in 2024.

Furthermore, its earnings per share are expected to grow by 24% in its fiscal year 2023 and another 17% in 2024, as inflation begins to subside and Dollarama’s margins improve.

Therefore, given the exceptional performance Dollarama has had in the past and the growth plans it has going forward, it could gain 25% this year, especially if the stock is undervalued or at least fairly valued.

Is Dollarama stock undervalued?

After such an impressive performance by Dollarama last year, and after its stock price gained 25%, it’s no surprise that when you look at Dollarama, the stock is fairly valued.

Right now, Dollarama has a forward price-to-earnings (P/E) ratio of roughly 26 times. That’s only slightly above its three-year average of 25.5 times and actually below its average over the last year of 27.4 times.

One of the reasons it has such a high P/E ratio yet is still considered fairly valued is due to the stock’s impressive growth rate. And considering that analysts expect its earnings per share to grow by 24% in fiscal 2023 and another 17% in fiscal 2024, it certainly looks possible that Dollarama stock could gain another 25% in value throughout 2023.

However, it’s important to note that while it’s definitely possible, it’s nowhere near a sure thing, and there are a few major risks to consider.

First off, there is execution risk. Dollarama’s growth that analysts and the market are expecting actually has to materialize. In addition, there is the risk that market conditions could change, and investors may not be willing to pay such a high premium for Dollarama, even if it’s such a high-quality company.

Therefore, if you’re bullish on Dollarama, it’s certainly worth an investment. However, to minimize risk, investors should always look to buy high-quality stocks like Dollarama to hold for the long haul.

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Author
danieldacosta