Dollarama Inc. (TSX:DOL): This Growth Story Is Nowhere Close to Over

Description

A number of factors have pushed **Dollarama** (TSX:DOL) shares down significantly in the last few months, sending shares tumbling from a high of $56 each to today's levels just over $32.

Ultimately, they all come down to one thing: investors are convinced this great growth story is starting to fizzle out. Even the prominent short-seller betting against Dollarama's shares has this as the centre of his thesis.

But I'm convinced these investors are missing out on some powerful reasons why Dollarama's growth story still has a long runway. Here are four you might have missed.

Dollar City

Investors have long known about Dollarama's interest in Dollar City, a chain of stores located in Central America. Besides having a call option to buy 50% of Dollar City — which is a virtual no-brainer to exercise in 2020 — Dollarama also sources product for the smaller chain.

In 2013, when Dollarama and Dollar City first agreed to work together, the latter had just 15 locations in El Salvador and Guatemala. These days the chain is up to 150 locations with 61 in Colombia, 42 in El Salvador, and 47 in Guatemala. Next up is an expansion into Peru and Ecuador.

Dollar City also plans to open larger stores, increasing the footprint from 4,000 square feet to anywhere from 6,000 to 8,000 square feet.

Growth potential in Central and South America is massive, and Dollar City is doing the right thing by expanding into markets with higher per capita incomes. There are approximately 100 million people in Colombia, Peru, and Ecuador. It's a prize that could easily one day rival Canadian operations.

Expansion at home

Dollarama currently has about 1,200 locations in Canada, with analysts saying the chain has potential to open an additional 500-1,000 stores.

But perhaps the market is even bigger than that. In the United States, an economy approximately 10 times bigger than Canada's, there are approximately 30,000 dollar stores. The two largest chains say they plan to open an additional 20,000 locations in the next decade or so. Americans are increasingly buying groceries at dollar stores, despite no fresh food selections.

If Canada follows the same trends, Dollarama has potential for thousands of additional locations.

U.S. dollar stores have also aggressively expanded into towns with just a couple thousand people, a market Dollarama hasn't even tried to tap. If it can successfully move into these places in Canada, watch out.

Dollarama's special sauce

In a world where there are a million places to spend your retail dollar, why is Dollarama special? It's a question many investors just can't figure out.

I know the answer. Dollarama is unique, because unlike those big-box stores, it isn't forced to carry everything. It can be selective.

The average Dollarama location has approximately 4,000 different items. A typical grocery store might have 30,000-50,000, while a big-box store might have closer to 100,000.

By limiting what it carries, Dollarama can pick and choose only the most profitable items for its stores. The chain consistently posts close to 40% gross margins, versus 20-25% for supermarket chains or big-box stores. Store expenses run about the same across different locations, which means Dollarama earns a much better net profit margin too.

Giving back to shareholders

Rather than paying a generous dividend — shares currently yield a paltry 0.5% — Dollarama gives back to its shareholders by repurchasing huge amounts of its own stock.

Since 2012 the company has decreased its share count by more than 125 million shares, decreasing the total stock outstanding from 453 million shares to 325 million today.

Management has been even more aggressive with the share buybacks lately, gobbling up more than seven million shares in the latest quarter. It recently gained approval to buy back more than 30 million shares by the end of fiscal 2019, which would knock an additional 10% off the outstanding float.

The bottom line

Investors should take advantage of Dollarama's recent troubles and buy the stock today. The chain has all sorts of growth opportunities it has only begun to explore, like international expansion and online sales, never mind additional opportunities in the main business. It trades at a reasonable valuation — just 14 times forward earnings — for the first time in years. And management continues to add value by eliminating shares.

Dollarama shares won't be this cheap forever. If you don't buy now, you might be kicking yourself later.

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