Dollarama (TSX:DOL) Stock Has a Hidden Growth Opportunity Few Recognize

Description

Dollarama Inc (TSX:DOL) is a hyper-growth stock. From 2009 through 2017, shares increased in value by 1,600%. Over the same period, the **S&P/TSX Composite Index** grew by just 47%.

Dollarama's dramatic rise isn't surprising, however. Over the last decade, profits have grown by nearly 40% per year. Profitability and store count went on a relentless rise — until recently.

Over the last 12 months, EPS growth slowed to just 3.5%. The firm is still growing, but it appears that the days of hyper-growth are over. In response, the stock has returned roughly 0% over the past two years.

The market is starting to give up on the stock, but management has a secret weapon that should fuel continued earnings growth over the next decade.

Look at the details

In March, I chronicled exactly how the market is getting Dollarama wrong. I first introduced the company's easiest growth opportunity: continuing to penetrate the Canadian market.

The discount retailer already has more than 1,200 domestic locations, but millions of Canadians still don't live within a few hours of a Dollarama store. "In fact," I wrote, "they may not live within a few hours of *any* store."

That's what makes the company's digital push so enticing. On January 22, 2019, Dollarama launched an online store that features over 1,000 products.

The nationwide rollout was the result of a successful five-week pilot program in Quebec. As the products on its digital storefront are sold only in bulk quantities, Dollarama is also positioning itself as a key supplier for small businesses, particularly in rural areas.

While this may look like yet another online storefront selling undifferentiated goods, that assumption is far from the truth. The company’s direct-sourcing model means that it often has exclusive products at prices competitors simply can’t match. Today, around half of its merchandise is purchased directly from manufacturers throughout 30 countries.

International is critical

While online shopping in Canada should provide another leg of growth that could last years, Dollarama’s biggest opportunity is abroad. In 2013, the company agreed to help Dollar City optimize its business.

Dollar City is a discount retail store that’s emulating Dollarama’s success in high-growth Latin American countries. In exchange for its expertise, Dollarama received an option to acquire a 50.1% interest in Dollar City.

In March, I wrote that “the market may have forgotten about this potential growth driver, but you shouldn’t.” Since that article, two key things happened. First, the company exercised its option to take a controlling stake in Dollar City.

Second, Dollarama stock increased in price by 40%. Despite the run, however, I think the market is *still* under-appreciating the value of the Dollar City acquisition.

In 2014, Dollar City had 25 storefronts. Over the next five years, its store count grew several-fold to 200. Over the next decade, the company is targeting 600 locations. With the direct assistance and funding of Dollarama, there’s reason to believe Dollar City can surpass these targets.

Eventually, I expect Dollarama to acquire the entirety of Dollar City, making it a fully owned subsidiary. Meanwhile, the domestic Dollarama business is still opening 60 to 70 stores per year. In combination with Dollar City, store count has the potential to *double* over the next decade.

By 2030, it’s not a stretch for Dollarama to more than double in size, especially given the additional cost and profitability improvements. While rapid growth of the past may not happen, there’s still plenty of upside left in this story.

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