Why Did Dollarama (TSX:DOL) Stock Plunge 21% in 30 Days?

Description

Dollarama Inc (TSX:DOL) was once a bonafide growth stock. In 2009, shares were priced at $3. Last year, they topped $50.

Since those highs, shares have taken a sharp dip, falling below the $40 mark. At these levels, Dollarama stock is a clear bargain. To take advantage of this situation, you need to understand why this company has been so successful — and why that success is ready to repeat itself this decade.

Here’s what happened

Dollarama is an incredible story. In 1992, it was founded as single price point retail chain. By 2009, it had surpassed 585 stores, allowing the firm to go public.

In 2012, it introduced multiple new price points, opening a path to become a broad-based discount retailer. It opened it 1,000th store in 2015 and is currently approaching the 1,200 mark.

How did Dollarama achieve such rapid growth? Perhaps its biggest secret is a low-cost direct sourcing platform.

Rather than buying from middlemen, Dollarama decided to engage with manufacturers themselves. This allows them more control and input into the product, providing better quality assurances and reliability, not to mention exclusivity on a variety of co-developed products.

It also reduces costs, giving Dollarama better profit margins and reducing price points for customers. It’s a win-win.

Today, around half of its merchandise is sourced directly from over 25 countries. While this approach takes time to develop, it results in a durable competitive advantages that encourages customer loyalty and discourages new market entrants.

See into the future

To be sure, the days of domestic growth are slowing, but they're not over. By 2027, Dollarama wants to operate 1,700 stores — a 30% increase from today's levels.

Still, the domestic story was responsible for historic growth, and the future isn't nearly as bright. There is concern that the company has already penetrated the highest-value locations.

Here's the thing: a slowdown in domestic growth is actually a *good* thing. Dollarama isn't growing more slowly because it's not successful.

The reality is exactly the opposite! Dollarama is slowing down because its nearing complete domination of Canada's discount retailer industry.

This is great news for the future. All the company needs to do is replicate its strategy abroad. Fortunately, it's already halfway there.

In 2019, Dollarama purchased a 50.1% interest in Dollarcity, which operates discount retailer stores in Latin America. The two companies had been working together in a lighter manner for years, integrating their systems and sharing knowledge.

Now that it has a controlling stake, expect Dollarama to turbocharge growth. Management recently noted that it wants to open 600 stores by 2029.

Due to Latin America's rapidly growing middle class, these stores could closely mirror the success of Dollarama's initial Canadian locations.

Why the drop?

In recent weeks, Dollarama stock has plunged 20%. The reason is clear: the coronavirus. While the virus should reduce foot traffic at the company's stores, it also poses a supply chain issue, as the company sources most of its products from China. Factory shutdowns could limit Dollarama's ability to stock its shelves.

While the coronavirus poses a meaningful risk, it will most likely be a temporary headwind. With continued domestic growth, plus an exciting decade-long growth project in Dollarcity, Dollarama stock looks like a buy at multi-month lows.

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