Dollarama Stock: Why it Might Finally Be Time to Buy

Description

Dollarama (TSX:DOL) is one of Canada's best-run retailers. Historically, the company's highest sales results have occurred in the fourth quarter, with December representing the highest proportion of sales. Sales also generally increase ahead of other holidays and celebrations, such as Easter, St. Patrick's Day, Valentine's Day, and Halloween, but the company otherwise experiences limited seasonal fluctuations in sales in the normal course of business.

Impact of COVID-19

Restrictions imposed by provincial authorities on retailers, including a stay-at-home order and a ban on the sale of non-essential goods, in reaction to a sharp rise in COVID-19 case counts across the country appear to have had a negative impact on traffic and sales.

The company's cost of sales consists mainly of inventory purchased, store occupancy costs, transportation costs, as well as warehouse and distribution centre occupancy costs. Although cost increases can negatively affect Dollarama business, the company's multiple price point product offering provides some flexibility to react to cost increases on a timely basis.

Use of low-cost foreign suppliers

Further, the company has historically reduced cost of sales by shifting most of Dollarama's sourcing to low-cost foreign suppliers. For fiscal 2021, direct overseas sourcing accounted for 53% of Dollarama's purchases. While Dollarama still sources a majority of overseas products from China, the company currently purchase products from over 25 different countries around the world.

Since the company purchases goods in currencies other than the Canadian dollar, Dollarama's cost of sales is affected by fluctuations in foreign currencies against the Canadian dollar. In particular, the company purchases a vast majority of Dollarama's imported merchandise from suppliers in China with United States (U.S.) dollars. Therefore, Dollarama's cost of sales is impacted indirectly by the fluctuation of the Chinese renminbi against the U.S. dollar and directly by the fluctuation of the U.S.

dollar against the Canadian dollar.

Unhedged exposure to Chinese renminbi

While the company enters foreign exchange forward contracts and zero-cost collar contracts to hedge a significant portion of Dollarama's exposure to fluctuations in the value of the U.S. dollar against the Canadian dollar, generally nine to 12 months in advance, the company does not hedge exposure to fluctuations in the value of the Chinese renminbi against the U.S. dollar.

Shipping and transportation costs, including surcharges on transportation costs, are also a significant component of Dollarama's cost of sales. When fuel costs fluctuate, shipping and transportation costs increase or decrease, because carriers generally pass on these cost changes to Dollarama. Due to the high volatility of fuel costs, Dollarama appears to find it difficult to forecast the fuel surcharges it may incur from carriers.

Impacts on future outlook

Also, Dollarama's inbound shipping costs are impacted by changing dynamics in the ocean shipping industry, most notably by the wave of market consolidation observed in container shipping in recent years. This continues to have an impact on shipping capacity and prevailing rates, especially in the context of the COVID-19 pandemic.

Despite these impacts, Dollarama should be a great stock to own over the long term.

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