Dollar General [NYSE: DG]

Initiate a BUY at 7.5% Weight| PT: $163.91

September 22nd, 2023

CIMG Investment Research

A Battered Stock

Dollar General (NYSE: DG) stock has fallen >50% YTD. Two straight quarters of missing EPS numbers and cutting full year EPS guidance by 22%-33% have caused a massive sell-off of the stock. Margin compressions due to shrink and inventory markdowns have decreased cash flow to the business. Due to this, management has said they will not repurchase any shares for the remainder of the fiscal year. Street sentiment has quickly turned negative on DG, with JPM – which had DG as a buy when they traded at ~$260 six months ago – downgrading DG to a sell earlier this week. We believe that DG now trades at an extremely attractive valuation and are therefore recommending a BUY at 7.5% weight.

Investment Thesis

Investments into Inventory Management will Drive Margins Up

Dollar General announced in 23Q1 that they would be making a $100 million investment into retail labor hours. Last quarter, they increased this number to $150 million. These labor hours are being distributed across DG's store base to fix the inventory management issues they have been experiencing. The investment also includes the creation of Smart Teams, which are dedicated teams that are at the disposal of a district manager to deploy at specific stores with extreme inventory issues. DG is also building out three new distribution centers. These buildouts will collectively add 20% to their distribution capacity. DG opened their first dual distribution center last month. The new distribution will combine DG's historically efficient legacy supply chain with its new DG Fresh initiative. The dual functionality of the new distribution center supports Dollar General's growth in its fresh and frozen product offerings, which make up the bulk of the DG Fresh selection. DG has also been continuing to build out their private tractor fleet. Currently, 50% of outbound transportation needs are met by DG's private truck fleet of ~1800. For every third-party truck replaced with one from their private fleet, DG saves 20% of the associated transportation costs. We believe that these investments will fix DG's current supply chain issues and increase margins in the long run.

Select Price Decreases will Increase Same Store Sales

DG completed select price cuts this past quarter, cutting prices 7% on less than 1% of SKUs, most of which were in the Consumables section. These price cuts come on the heels of the federal government cutting SNAP benefits. In both 2013 and 2016 SNAP benefits were also reduced, and DG cut prices to compensate for their core consumer having less spending power. Historically, after SNAP benefits are reduced, DG sees a decrease in foot traffic and Same Store Sales growth. This has been followed by price decreases on select items in the Consumables category. Same Store Sales growth usually has a lag of ~2 quarters following price decreases. We believe we will see a similar trend this time, with Same Store Sales increasing in either Q1 or Q2 of 2024.

Consumer Staples

Cole Davis – Committee Head
cbdavis20@crimson.ua.edu

Will Guy – Committee Head
wmguy@crimson.ua.edu

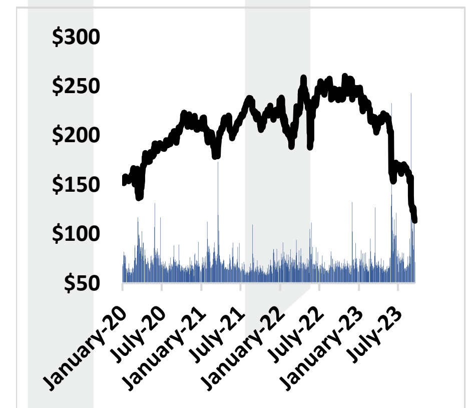
Ethan Sneckenberger – Analyst
ebsneckenberger@crimson.ua.edu

Caroline Egger – Analyst
coegger@crimson.ua.edu

Walt Shelton – Analyst
Whshelton1@crimson.ua.edu

Alex Nowicki – Analyst
Asnowicki1@crimson.ua.edu

Figure 1: LTM Stock Chart & Volume



Price	$108.14
Dividend Yield	2.18%
PT	$163.91
Upside	52%
52-Week Range	$107.72-261.59
Dil Shrs Outstand	219.9 M
Mkt Cap	$23.78 B
Ent Value	$42.63 B
NTM P/E	13.72x
NTM EV/EBITDA	12.26x

Dollar General is a Better Business than Dollar Tree

The two biggest dollar store corporations in America are Dollar General and Dollar Tree. The two companies have ~35,000 stores between them. We originally pitched and bought Dollar Tree in 2021. The past committee wanted to pitch DG, but felt it was too expensive at their past valuations. Now, DG trades at ~11.5x TTM PE and ~7x TTM EV/EBITDA, while DLTR trades at ~19x P/E and ~8.5x EV/EBITDA. The Family Dollar segment had strong foot traffic and Same Store Sales growth this past quarter, while DG had a slight decrease in SSS growth. However, Family Dollar had very easy comps, as the business was losing foot traffic last year while DG was gaining. Dollar Tree stock has still fallen in the past two quarters, but not as much as DG. DG is currently experiencing worse supply chain issues and inventory markdowns when compared to their historical standard, yet they still have higher margins and cash flow than Dollar Tree. Family Dollar, which is owned by Dollar Tree and makes up ~half of the Dollar Tree business, is still unprofitable. New management at Dollar Tree claims Family Dollar is roughly 3-5 years away from a turnaround. However, Family Dollar has been 3-5 years away from a turnaround since Dollar Tree bought them in 2015. The segment is operating at almost all-time lows.

We are not Concerned with Regulatory Issues

Some small and relatively poor cities across the country have started to take steps to regulate the expansion of dollar stores. These politicians make the argument that dollar stores create food deserts. Local competition cannot compete with their prices, and usually have to shut down. While there is truth to these arguments, we are not concerned for the following reasons: The only places that these regulations are going into affect are in cities. No rural towns or communities, which is where DG operates 80% of their stores, have regulated their business. Furthermore, the vast majority of these regulations are restricting future store growth. Most of these laws have requirements stating that new dollar stores cannot open within 5 miles of another dollar store. While this could hurt future expansion, there is almost no threat to currently operating stores.

Valuation

We arrive at a $163.91 price target for DG using a DCF valuation. The three biggest drivers of our DCF are new store buildout, same store sales growth, and operating margin. We model out 880 new store openings for all of FY 2023, which is below guidance. Due to recent decreases in cash flow, we wanted to put in a margin of safety. We have new store buildout slowly decreasing over our projection period, as the market continues to get more saturated. We model out a decrease in same store sales growth for the next two quarters to reflect price decreases. We then model same store sales growth flat for 2024, before rising again in 2025. Again, we wanted to include a margin of safety on our thesis. Finally, we have operating margin at 6.4% for all of FY 2023. It then drops to 6% for all of 2024, before rising in 2025. We have operating margins reaching 8.9% by 2029, and then staying flat for the rest of the projection period. 8.9% is slightly higher than their pre-Covid averages. We use a 50/50 blended upside. Our long-term growth model gives us a price target of $156.52 using a 10% discount rate and a 2% long-term growth rate. Our EV/EBITDA valuation gives us a price target of $171.31 using an 8x EV/EBITDA multiple and 10% discount rate.

Industry Overview

The retail space is made up of club wholesalers, large chain supermarkets, and dollar stores. Large chain supermarkets, like Target and Walmart, have high startup costs for new stores, typically being around $10-20 million to buy the land and build the store. A club wholesaler like Costco typically has start up costs of roughly $30 million, while dollar stores are around $250,000. Usually, higher income consumers shop at a club wholesaler like Costco since they can afford to buy the membership. Walmart sees more middle-income shoppers, and dollar stores have the lowest income demographic. Dollar stores compete with these larger stores by offering smaller quantities of goods for very similar price/unit.