DOLLAR GENERAL

Analysts:

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Dollar General Corporation
NYSE: DG
Recommendation: BUY

Company Data

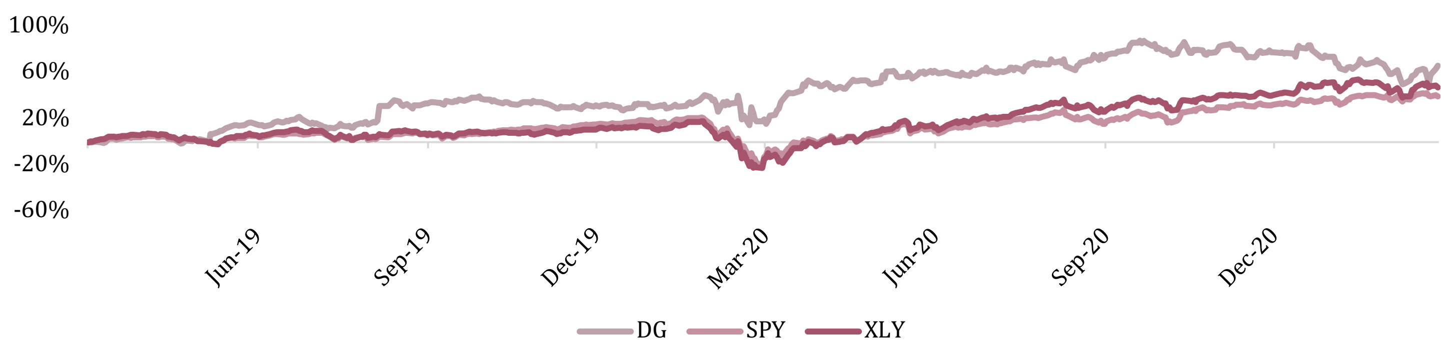
Price	$197.78
Market Cap	$47,52B
P/E	18.57x
EBITDA	$4.13 B
EV/EBITDA	12.45x
Price Target	$239.98
Upside	21.3%

Investment Thesis

We recommend a buy on Dollar General Corporation (DG) with a target price of $239.98 and an implied upside of 21.3%. Dollar General is a discount retailer with more than 17,000 stores across the United States.

DG's stock price may have declined in recent months due to the company missing estimates for the 2020 fiscal year, the broad pullback in pandemic beneficiaries and the market's assumption that essential retailers will face difficult comp numbers in 2021. However, we believe that Dollar General can sustain its pandemic-fueled momentum thanks to their investments in unique digital initiatives, continuing rollout of DG Fresh, and aggressive physical expansion which will enhance margins and drive y/y sales growth. Furthermore, DG's expansion into more suburban areas, along with the aforementioned strategies, are expanding the company's customer base, which is skewing evermore wealthy and diverse. Finally, Dollar General's business model has allowed it to capitalize on pandemic-driven demand and will enable it to navigate the now changing macroeconomic conditions better than rivals, ultimately gnawing away at their market share.

Two-Year Performance



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Business Overview:

Dollar General is a Tennessee-based discount retailer that is among the largest of its kind in the United States with 17,177 stores in 46 states. Their business model consists of offering basic everyday and household items, along with a variety of other general merchandise, to the broadest possible customer base at competitively low prices, typically below $10. As well as national brand products, Dollar General sells its own private brand items. Their stores are concentrated in the southern and midwestern United States with a notable presence in rural America. The company places an emphasis on opening stores in convenient locations to drive higher traffic. Dollar General keeps the initial investment cost of opening new stores low, and once they're open, keeps expenses at a minimum with a low-cost operating model.

End Market Overview:

The Dollar and Variety store industry has expanded over the past few years. This industry has historically targeted a lower income consumer base, however in recent years has expanded to include middle-class and even some high-income earning consumers. The total industry revenue is expected to grow from $92.4 billion in 2021 to $101.4 billion in 2026, at an annualized rate of 1.5%. Historically this industry has done well during economic downturns, and poorly during periods of economic expansion. However, the industry is heading in the direction of providing higher quality products while maintaining their low prices, making it less cyclical.

Margin Enhancements through Aggressive Initiatives:
DG has pursued a series of initiatives to bolster its margins. The company has improved labor productivity through its implementation of self-checkout lanes, which it dubs "Fast Track" and DG Go which allows customers to pay in app. The rollout of "Fast Track" systems is ongoing with over 700 stores being added in the last quarter. In addition, Dollar General is pushing to add more non-consumables to its stores through a program it calls NCI. The ~5,200 of its locations where this program is implemented have experienced an 8% increase in comp sales. This will help shift the sales mix towards higher-margin products. DG Fresh unlocks the ability to increase penetration of private brands such as Clover Valley. Other private brands include True living, which is their laundry brands, and DG Office which carry higher margins but are also sold at a significant discount, which could encourage a quicker shift in sales mix. DG is also continuously improving on overseas sourcing, and improving inventory shrink through the implementation of EAS units in 40% of its stores as of last quarter.

Growing Customer Base Diversity:
Dollar General has remained proactive in its responses to shifts in consumer demands through a series of programs that continue to attract first-time customers. The ongoing rollout of DG Fresh, the company's vertically integrated program to offer fresh produce at its stores, represents the company's response to the rise of the health-conscious customer. In response to changing consumer behavior in 2020, the company took swift steps to drive higher foot traffic. These include a partnership with FedEx, allowing customers to retrieve packages at its locations, and the introduction of DG Pickup, an online curbside pickup service in which customers retrieve their orders in-store. Additionally, the company has ramped up efforts to penetrate new markets with the launch of pOpshelf, a sub-brand which focuses on higher-margin products, and targets higher income suburban customers. pOpshelf has already proven to be a successful initiative for DG after its pilot rollout in October 2020, and DG plans to open 50 stores under the pOpshelf name in 2021. Furthermore, larger Dollar General-branded stores drive higher sales volumes, according to internal testing, thanks to a higher number of checkout lanes and the ability to accommodate DG's new product offerings. DG has thus increased its standard store model by 16% to 8,500 sq. ft., of which it intends to open 1,000 in 2021.

Agile Business Model during Shifting Macroeconomic Conditions Creates Good Entry Point:
DG's agile business model enables the company to rapidly expand its network into food deserts where large-box competitors cannot afford to operate. This grants the company near monopolistic dominance in its core market. Dollar General commands a 36.3% market share in the Dollar and Variety sector and has exposure to other sectors as well. This bolsters its resilience to cyclical effects in the economy and was demonstrated in the aftermath of the 2008 financial crisis with a two-year stack of 14.4% in 2010 and 10.9% in 2011. Therefore, we believe that the current pullback we see in the market from "pandemic beneficiaries", enables the current economic environment to be a good entry point.

Catalysts

1. Shift to higher-margin non-consumables
2. Better than expected comp sales figures in 2021
3. Rapid expansion of pOpshelf brand
4. Economic stimulus boosting near-term revenue

Risks

1. Downward price pressure from competitors
2. Rapid increase in the minimum wage
3. Elevated costs from investments in new initiatives
4. Failure to attract higher-earning customers due to limited product offerings at pOpshelf locations

Comparable Company Analysis

Given Dollar General's relative value to peers despite faster customer base expansion and what we believe to be a superior business model, DG is the most attractive peer. Dollar General's ongoing initiatives have already demonstrated early success which we believe is not fully reflected in the market, shown by the company's lower P/E ratio relative to peers and DG's considerably higher ROIC and ROE. Dollar General's Non-Consumables Initiative will bring its sales mix closer in line with that of FIVE, which has a 23x higher P/E ratio. Despite intense competition in the industry, DG's efforts to grow will not be inhibited as we articulated in our thesis points.

Valuation

Using a Discounted Cash Flow model and a conservative EV/EBITDA multiple of 17.0x for the base case, we found an implied upside of 21.3% and a targeted share price of $239.98. For the bear case, we found an implied upside of 13.4%, and a targeted share price of $224.27. For the bull case, we found an implied upside of 32.0%, with a targeted share price of $216.16. To arrive at our multiple outputs, we considered overall expansion, as well as revenue and individual segment growth. We attributed this growth largely to Dollar General's efforts to grow margins, increase its new customer outreach, and the current market sentiment regarding essential retailers, based on historical trends. We were conservative with our assumptions as we understand there are risks associated with certain initiatives such as pOpshelf and NCI, as well as customer retention in the post-pandemic economy.