Dollar General Corp.

CONSUMER DISCRETIONARY | NATHAN SCHOMBERG AND RYAN DAVID

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Ticker: DG	Stock Exchange: NYSE
Sector: Consumer Discretionary	Current Price: $162.91
Industry: Discount Retailer	Valuation Date: October 25, 2019

COMPANY OVERVIEW

Dollar General Corporations has been around since 1939. It was first called J.L. Turner and Son in Scottsville, Kentucky, owned by James Luther Turner and Cal Turner. They have grown since and operate across the country with over 16,000 locations and now has the name Dollar General. Dollar General is in the Discount Retailer industry with most of their sales from brick and mortar locations. They sell food, snacks, health and beauty aids, cleaning supplies, family apparel, housewares, seasonal items, paper products and much more at a discount price and focus their locations in mostly rural areas. The average customer is 35-65 years old and has a household income of less than $50,000 a year. The company places their locations 15-20 miles away from the nearest big box or grocery store and keeps low expenses by not owning their buildings.

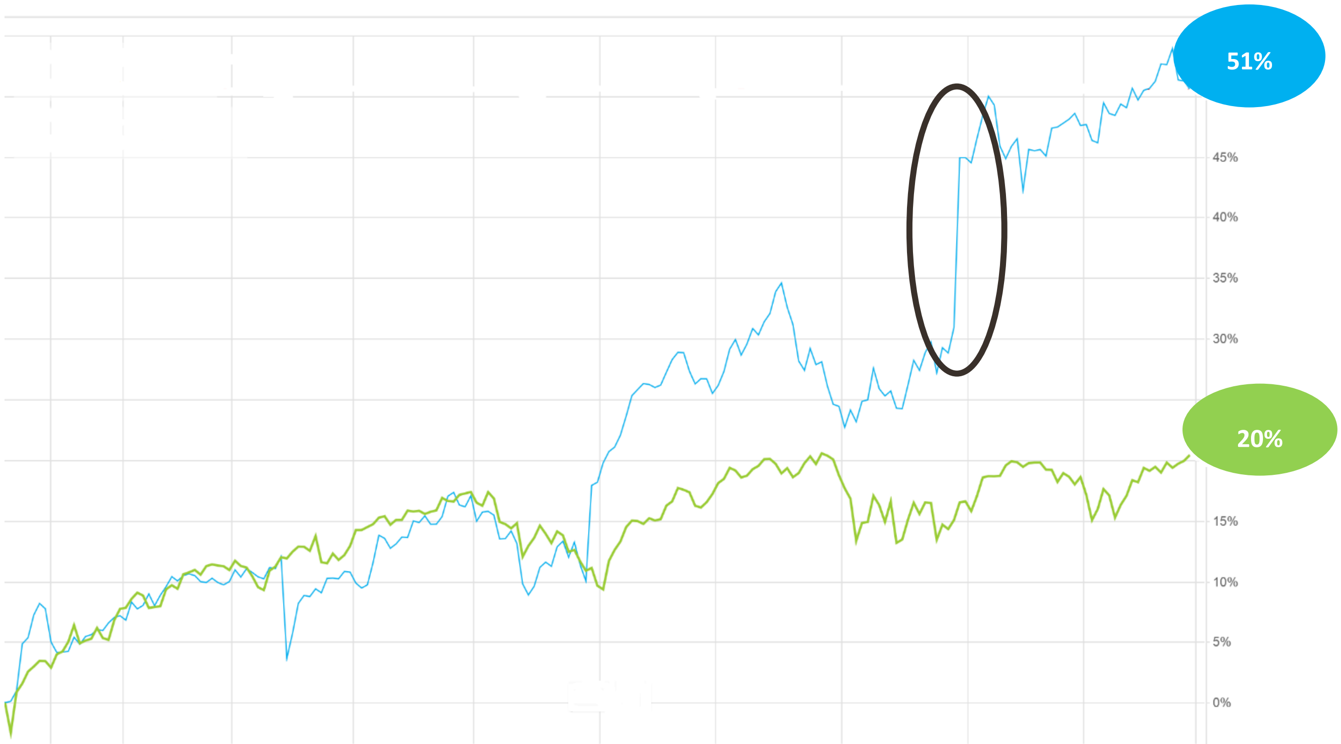
MANAGEMENT

Dollar General's management team is led by Chief Executive Officer Todd Vasos. Mr. Vasos has only been the CEO of Dollar General since 2015 but joined the board in 2008 working his way up to the position he has today. In the past year alone Todd Vasos has been responsible for opening of 900 new retail locations. Considering many retailers have been downsizing their brick and mortar presence this margin of growth is remarkable. Next in line Chief Financial Officer John W. Garratt has been with Dollar General since 2014. Prior to joining Dollar General John held various positions in the Yum! Brand one of the world's largest restaurant companies. Another important position in Dollar General held by Mike Kindy is Executive Vice President and head of Global Supply Chain. Prior to joining Dollar General Mr. Kindy has had 14 years of grocery distribution management and 5 years of logistics and distribution consulting experience. Dollar General's management team has not only had experience running the company but have held extremely relevant positions outside of the company that will help to continue Dollar General's growth.

PRICE PERFORMANCE

Dollar General's stock has been publicly traded since late 2009. Since then, it has had a 605% return compared to the S&P's 176%. It currently at its highest price yet. Additionally, Dollar General has a 3 year Raw Beta of 0.80.

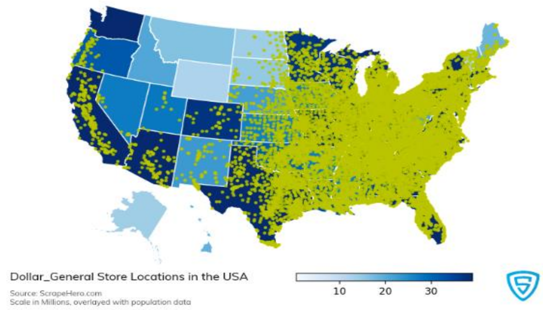
Below is shown the YTD of Dollar General's Stock to the S&P 500. There is a 31% spread between the two with Dollar General having a 51% return to the S&P's 20%. Circled on the graph is the big jump in Dollar General's Stock price from August to September. The reason this jump likely took place was because their Q2 net sales reports exceeded expectations by 0.1 billion dollars (which was a shock to investors considering the tariffs had almost no impact on their financials).



INVESTMENT THESIS

1) Driving profitable sales growth: Dollar General has seen an increase in annual revenue each year for well over a decade. Over the previous fiscal year, they saw an increase in net sales by 9.2%. This positive sales growth not only came from new store openings, but from an increase in same-store sales. Going into the 2019 fiscal year Dollar General had predicted a 7% net sales growth, this number has recently been changed to 8% as expectations for this company rise.

2) Capturing growth opportunities: Dollar General focuses their company growth by taking advantage of location expansion. As a company, Dollar General is very efficient with opening, closing, and relocating stores. Since 2008 they have almost doubled in amount of locations. From 2018 to 2019 they opened 900 and only closed 64. The big shift was in the early 2000's when one of their Chief Executives, David Perdue, shared with the Wall Street Journal was to go into communities where Walmart wasn't. Below is a density map of the United States (left) compared to Dollar General Stores (right).



3) Enhancing our position as a low-cost operator: Dollar General has continued to gain market share as customer visits and average spending have both increased. A key aspect of recent spending to increase market share has been to increase the distribution of perishable goods, mostly fresh and frozen items. This intuitive called DG Fresh will cut product costs, keep items in stock better, and carry more fresh items. Giving rural markets facing food deserts Dollar General's new fresh healthier food options will cater to these consumers increased demands.

4) Investing in our people as a competitive advantage: Dollar General has a simple mission – serving others. They do this not only with their customer service and daily operations, but since 1993, the Dollar General Literacy Foundation (DGLF) has awarded more than $172 million in grants to nonprofit organizations that have helped more than 11 million individuals learn to read, prepare for their high school equivalency test or learn English.

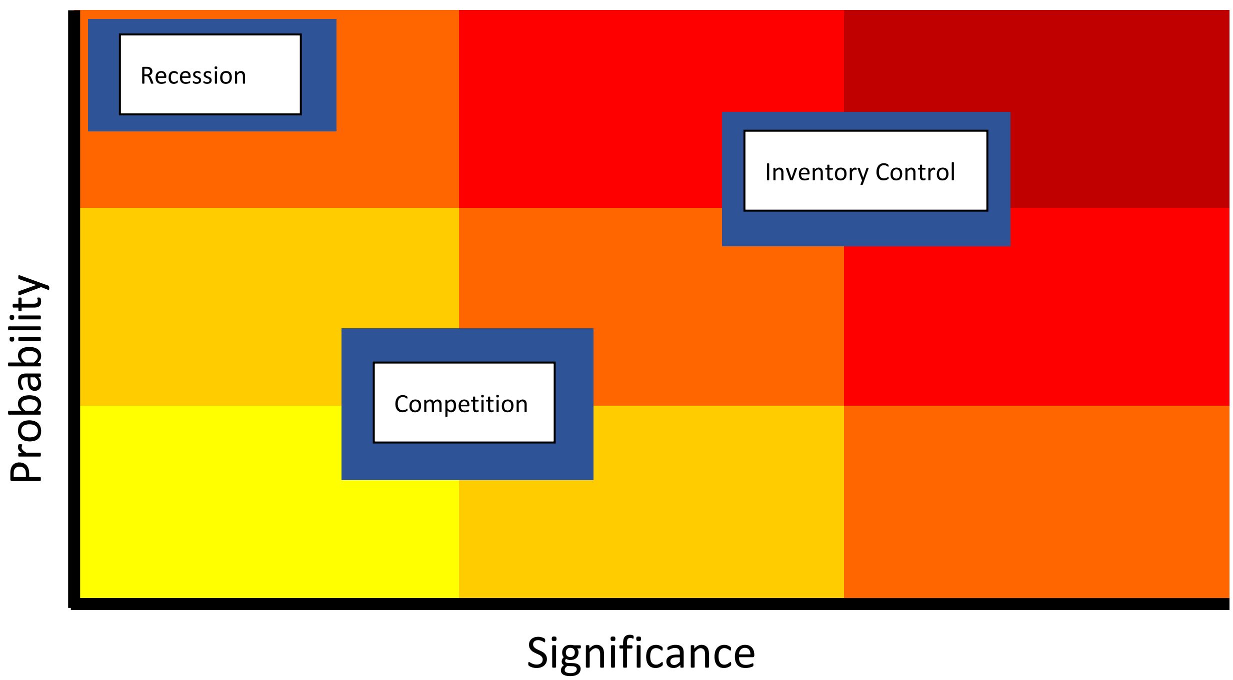
DOLLAR GENERAL LITERACY FOUNDATION

RISKS

Dollar General faces many risks as every company does. The three most important risks we focused on are recession, competition, and inventory control. One risk that has the highest probability to occur but the lowest to significance is a recession. Dollar General is not completely recession proof, but they are close to it. Regardless of the economy, Dollar General's low-income customer base will continue to buy necessities from them. Those who are not usually customers but are facing increased financial pressure will turn to discount retailers such as Dollar General.

Competition is another risk that Dollar General faces as it goes against retail and ecommerce giants such as Walmart and Amazon. The reason this risk is low on our heat map is because Dollar General scopes out a different target market compared to their competitors. Around 75% of Dollar General's stores are in towns with populations less than 20,000. Many of these towns don't have another store where they can get their groceries and household necessities. Dollar General can operate and remain profitable in smaller towns that big box stores such as Walmart would not be able to thrive in. Dollar General has limited competition from Amazon as well as their target markets annual income is under $50,000 a year, with 33% under $25,000. Their customers are unable to afford monthly fees and subscriptions that Amazon has forcing them to shop at the local discount store. Consumers have also shown hesitance when purchasing food products online, which is a large part of Dollar General's business .Another advantage Dollar General holds during a recession and over its competitors is its store concepts. There average store size is 7,400 square feet is significantly smaller than competitors such as Walmart which averages 187,000 square feet per store. This allows Dollar General to expand to areas with less competition while spending less capital. A large portion of their stores are also leases allowing them to spread capital cost over a 10-15-year timeline. With leases a large portion of cash is not tied into real estate which is an effective strategy when the economy struggles. This also allows them to relocate stores if they are unsuccessful.

The last risk we focused on was how Dollar General faces inventory control. Current conflicts with China could lead to the increase in tariffs between the two countries. This Tariff could potential increase prices of common goods sold at Dollar General. An increase in prices would eat into their profit margins and may force them to increase in prices which can drive customers away. One ratio related to this that also draws cause for concern is Dollar General's inventory turnover ratio which is slightly below the industrial average meaning some inventory may be selling at a slower rate.



VALUATION

To determine our target price, we combined two methods – a discounted cash flow as well as a multiples method.

Multiples Method: For our multiples method we compared Dollar General to their competitors: Dollar Tree, Fred's A, Rite Aid, Big Lots, and Walmart. We personally don't think Walmart is within the same industry and is not a true competitor, however because of the weaker financial performances from other companies we wanted to include them in the average to even things out when comparing against the industry. We had to use Price/FCF for our multiples method since other methods didn't show consistent metrics across the industry. The current industry price/FCF average without Walmart gave a very high valuation, so by adding Walmart it gave a more conservative and realistic industry average of 30.14x. Using this data, we have a target price of $176.85.

Discounted Cash Flow (DCF): For the WACC of our DCF, we used 4.75% since historically it has been around the 4.5-5 range. We figured this would be a safe WACC since they have been very consistent with their financials for almost a decade. For our perpetual growth rate, we used 3.0% to be slightly conservative. Then, we adjusted Dollar General's revenues in a manner that we think would reflect their position with a potential recession as well as how their performance would be years after. From this, we got a target price of $173.48.

Since both methods involve a lot of assumptions and add-ons, we gave each a weight of 50% since we don't feel one is more realistic than the other. Doing this we have a target price of $175.17. With conservative measurements this gives an upside of 7%.

Price/FCF = 27.78x, Industry Avg = 29.21x, Shares = 259.1, Price = 162.91, FCF = 1520.3 ,259.1X/1520.3 = 29.21… X = 171.39

PEER ANALYSIS

Dollar General has a limited scope in companies to compare too that really follow their same business model. The main themes that we saw most valuable within the industry is the following: increase sales year to year, increase net income year to year, increase number of stores year to year, price/FCF, inventory turnover, and 1 year beta. Dollar General outperformed their competitors and the industry average in each of these areas with exception to inventory turnover and dollar tree in the 1 year beta.

Note: Walmart **IS** only included in the Price/FCF to even out the average. (Walmart's P/FCF is 20.21x).

Name	Sales Increase %	Net Income Increase %	Stores Increase %	Price/FCF	Inventory Turnover	5 Year Beta
Dollar General	8.5%	3.28%	5.96%	27.76x	4.46x	0.70
Dollar Tree	2.4%	-192%	0.36%	30.14x	4.83x	0.70
Fred's A	-29.4%	1.50%	N/A	N/A	4.11x	1.50
Rite Aid	0.1%	-90.81%	-0.36%	N/A	8.88x	1.38
Big Lots	1.0%	-17.35%	1.43%	40.06x	3.81x	0.94
Average	-6.5%	-59.08%	0.48%	30.14x	5.41x	1.13

RECOMMENDATION

We recommend a **BUY** for Dollar General. Dollar General is a strong stock that still have room to grow whether we find ourselves in a recession or a booming market. They have continual sales and store growth with little competition from competitors. They have strong management and even stronger performing ratios compared to similar competitors. Dollar General is a strong stock with a vigorous outlook economically and financially.