

# **Dollar General Corporation, Q1 2022, Earnings Call**

## **2022-05-26**

### **Presentation**

#### **Operator**

Good morning. My name is Robert, and I'll be your conference operator today. At this time, I'd like to welcome everyone to Dollar General's First Quarter 2022 Earnings Call. Today is Thursday, May 26, 2022. All lines have been placed on mute to prevent any background noise. This call is being recorded. Instructions for listening to the replay of this call are available in the company's earnings press release issued this morning. Now I'd like to turn the conference over to Mr. Donny Lau, Vice President of Investor Relations and Corporate Strategy. Mr. Lau, you may begin the conference.

#### **Donny Lau**

Thank you, and good morning, everyone. On the call with me today are Todd Vasos, our CEO; Jeff Owen, our COO; and John Garratt, our CFO. Our earnings release issued today can be found on our website at [investor.dollargeneral.com](https://investor.dollargeneral.com) under News & Events. Let me caution you that today's comments include forward-looking statements, as defined in the Private Securities Litigation Reform Act of 1995, such statements about our financial guidance, strategy, initiatives, plans, goals, priorities, opportunities, investments, expectations or beliefs about future matters and other statements that are not limited to historical fact. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. These factors include, but are not limited to, those identified in our earnings release issued this morning under Risk Factors in our 2021 Form 10-K filed on March 18, 2022, in any later filed periodic report and in the comments that are made on this call. You should not unduly rely on forward-looking statements, which speak only as of today's date. Dollar General

disclaims any obligation to update or revise any information discussed in this call, unless required by law. At the end of our prepared remarks, we will open the call up for your questions. Please limit your questions to one and one follow-up question, if necessary. Now it's my pleasure to turn the call over to Todd.

## **Todd Vasos**

Thank you, Donny, and welcome to everyone joining our call. We are pleased with our strong start to 2022, and I want to thank our associates for their unwavering commitment to serving our customers, communities and each other. Our Q1 performance was led by stronger-than-expected sales results in our consumable category, where we delivered comp sales growth of 4.6%. This increase was offset by a decline of 15.1% in our combined non-consumable categories, which we believe reflects the challenging lap of the stimulus benefit in Q1 of 2021. In addition, we continue to experience headwinds from ongoing global supply chain pressures and rising cost inflation. Despite these challenges, we remain focused on controlling what we can control and the team's disciplined execution was the key to delivering solid financial results that exceeded our Q1 expectations for both sales and EPS, while also advancing our key operating priorities and strategic initiatives. I'm also pleased to report that we have continued to make improvements in our overall in-stock position, which we believe positions us well to drive strong top line performance through the remainder of the year. In addition, while we continue to see ongoing product cost inflation, we feel good about our price position, as our price indexes, relative to competitors and other classes of trade, remain in line with our targeted and historical ranges. And with more than 18,000 stores located within five miles of about 75% of the US population, we believe we are well positioned to continue supporting our customers through our unique combination of value and convenience, especially in a more challenging economic environment. Looking ahead, we remain focused on advancing our operating priorities and strategic initiatives as we continue to strengthen our competitive position, while further differentiating Dollar General from the rest of the retail landscape.

Now, let me recap some of the additional financial results for the first quarter. Despite lapping a difficult quarterly sales comparison from prior year, net sales increased 4.2% to \$8.8 billion and comp sales were essentially flat with a slight decrease of 0.1%. From a monthly cadence perspective, comp sales were positive in February before turning negative in mid-March as we began to lap the stimulus benefit from prior year. As we move past the most challenging portion of the sales lap from 2021 comp sales turned positive in April, and we are pleased with our strong start to Q2, which has exceeded our initial expectations. As a result of our Q1 outperformance and strong start to Q2 as well as our expectations for the remainder of the year, we are increasing our sales outlook for fiscal 2022, which John will discuss in more detail shortly. Our first quarter sales results included a decline in customer traffic, which was mostly offset by growth in average basket size driven largely by inflation. Importantly, we are pleased with our market share gains in highly consumable product category sales for the quarter. These results were highlighted by gains in our frozen and refrigerated product categories, where we have placed a good deal of emphasis over the past few years in an effort to provide customers with an even wider variety of options. I'm also excited to note that we recently published our fourth annual Serving Others Report, which provides several important updates on our ongoing ESG efforts, as well as new and updated performance metrics and targets. We are proud of the team's efforts to serve our employees, customers, communities and the environment, and we look forward to continued progress on our journey as we move ahead. Overall, we are proud of our Q1 results. Our mission and culture remain unchanged, and we believe our strategic actions, which have transformed this company in recent years, positions us well for continued success, while supporting long-term shareholder value creation. We continue to operate in one of the most attractive sectors in retail and our unique value and convenience offering continues to resonate with both new and existing customers. I have never felt better about the underlying business model, and I'm excited about the opportunities ahead of us in 2022 and beyond. With that, I will now turn the

call over to John.

### **John Garratt**

Thank you, Todd, and good morning, everyone. Now that Todd has taken you through a few highlights of the quarter, let me take you through some of its important financial details. Unless we specifically note otherwise, all comparisons are year-over-year, all references to EPS refer to diluted earnings per share, and all periods noted refer to the corresponding fiscal period. As Todd already discussed sales, I will start with gross profit. As a reminder, we expanded our gross margin rate by 208 basis points in Q1 2021, which was positively impacted by a significant increase in sales, including net sales growth of 16% in our combined non-consumable categories. For Q1 2022, gross profit as a percentage of sales was 31.3%, a decrease of 151 basis points. The decrease compared to Q1 2021 was primarily attributable to a greater proportion of sales coming from our consumables category, a higher LIFO provision, increases in transportation costs, markdowns as a percentage of sales and distribution costs and higher inventory damages. Of note, while we have seen some moderation from Q4, our Q1 supply chain expenses were significantly higher compared to Q1 2021, resulting in a headwind to gross margin of approximately \$85 million. In addition, product cost inflation was greater than expected, resulting in a LIFO provision of approximately \$61 million during the quarter. These factors were partially offset by higher inventory markups. SG&A as a percentage of sales was 22.8%, an increase of 78 basis points. This increase was driven by expenses that were greater as a percentage of sales, the most significant of which were retail labor, store occupancy costs, depreciation and amortization and utilities. These increases were partially offset by reductions in incentive compensation and winter storm related disaster expenses. Moving down the income statement, operating profit for the first quarter decreased 17.9% to \$746 million. As a percentage of sales, operating profit was 8.5%, a decrease of 229 basis points. Our effective tax rate for the quarter was 21.8% and compares to 22% in the first quarter last year. Finally, EPS for the first quarter decreased 14.5% to \$2.41. Turning now

to our balance sheet and cash flow, which remains strong and provide us the financial flexibility to continue investing for the long-term, while delivering significant returns to shareholders. Merchandise inventories were \$6.1 billion at the end of the first quarter, an increase of 19.4% overall and 13.3% on a per store basis. This increase primarily reflects the impact of product cost inflation, as well as a greater mix of higher value products. Importantly, we continue to believe the quality of our inventory is in good shape and that we are well-positioned with the right mix and balance of products. Going forward, as Todd mentioned, we expect continued improvement in our overall in-stock levels as we move through 2022, underscoring our optimism that we are well-positioned to serve our customers. The business generated cash flow from operations during the quarter totaling \$450 million, a decrease of 36%. Total capital expenditures for the quarter were \$282 million and included our planned investments in new stores, remodels and relocations, distribution and transportation projects and spending related to the strategic initiatives. During the quarter, we repurchased 3.4 million shares of our common stock for \$747 million and paid a quarterly cash dividend of \$0.55 per common share outstanding for a total payout of \$125 million. At the end of Q1, the remaining share repurchase authorization was \$1.4 billion. Our capital allocation priorities continue to serve us well and remain unchanged. Our first priority is investing in high-return growth opportunities, including new store expansion and our strategic initiatives. We also remain committed to returning significant cash to shareholders through anticipated share repurchases and quarterly cash dividends, all while maintaining our current investment grade credit rating and managing to a leverage ratio of approximately three times adjusted debt to EBITDAR. Moving to an update on our financial outlook for fiscal 2022. Despite the ongoing uncertainties arising from cost inflation and continued pressure in the supply chain, we are confident in the business. As a result, and as Todd noted, we are increasing our sales outlook for 2022, as we now expect the following, net sales growth of approximately 10% to 10.5%, including an estimated benefit of approximately two percentage points from the 53rd week, and

same-store sales growth of approximately 3% to 3.5%. Additionally, we are reiterating the remainder of our financial guidance for 2022, which includes EPS growth of approximately 12% to 14%, including an estimated benefit of approximately four percentage points from the 53rd week. Share repurchases of approximately \$2.75 billion and capital spending in the range of \$1.4 billion to \$1.5 billion. Our updated outlook reflects our strong year-to-date top line performance and current sales expectations for the remainder of the year, as well as updated margin and expense expectations. Let me now provide some additional context as it relates to our outlook. In terms of the quarterly cadence, we continue to anticipate both comp sales and EPS growth to be stronger in the second half of the year than the first half. We also expect our share repurchases to be lower in Q2 and Q3 compared to the Q1 amount, before increasing in Q4, partially as a result of the extra week in our fiscal year. Turning now to gross margin for 2022. We expect to continue realizing benefits from our initiatives, including DG Fresh and NCI throughout the year. In addition, we are optimistic that distribution and transportation efficiencies, including significant expansion of our private fleet, can drive additional benefits despite anticipated continued cost pressures in the near term. Offsetting some of these benefits is an expected increase in sales mix pressure, as our sales outperformance has been predominantly driven by growth in our consumables category, which generally has a lower gross profit rate than other product categories. In addition, we expect ongoing supply chain pressures, including higher fuel costs, increased product cost inflation and expect to return to pre-pandemic rates of seasonal markdowns and increased inventory damages, all of which are expected to be headwinds in 2022. With regards to SG&A, we expect continued investment in our strategic initiatives, as we further the rollouts. However, in aggregate, we continue to expect they will positively contribute to operating profit margin in 2022, as we expect the benefits to gross margin from our initiatives will more than offset the associated SG&A expense. We also continue to pursue efficiencies and savings through our Save to Serve program, including Fast Track, and we believe these savings in 2022 will offset a portion of

expected wage inflation. Finally, our updated outlook includes plans to build on our sales momentum with targeted investments to further enhance the customer experience, including incremental labor hours to drive an even greater improvement in overall in-stock levels and customer service. In summary, we are proud of our team's resilience and commitment to execution, which resulted in our strong first quarter results. As always, we continue to be disciplined in how we manage expenses and capital with the goal of delivering consistent, strong financial performance, while strategically investing for the long term. We remain confident in our business model and our ongoing financial priorities to drive profitable same-store sales growth, healthy new store returns, strong free cash flow and long-term shareholder value. With that, I will turn the call over to Jeff.

## **Question and Answer**

### **Jeff Owen**

Thanks, John. Let me take the next few minutes to update you on our operating priorities and strategic initiatives. Our first operating priority is driving profitable sales growth. We are off to a great start to the year, as we continue to make good progress across our portfolio of growth initiatives. Let me take you through some of the recent highlights. Starting with our nonconsumables initiative or NCI, which was available in more than 13,000 stores at the end of the first quarter. We continue to be very pleased with the strong sales and margin performance we are seeing across our NCI store base, including continued incremental 2.5% total comp sales increase on average in NCI stores in their first year post implementation, along with a meaningful improvement in gross margin rate. We expect to realize ongoing sales and margin benefits from NCI in 2022 and are on track to complete the rollout across nearly the entire chain by the end of the year. Moving to our pOpshelf store concept, which further builds on our success and learnings with NCI. As a reminder, pOpshelf aims to engage customers by offering a fun, affordable and differentiated treasure hunt experience, delivered through continually re-

freshed merchandise, a differentiated in-store experience and exceptional value with the vast majority of our items priced at \$5 or less. During the quarter, we opened 11 new pOpshelf locations, bringing the total number of stores to 66. Additionally, at the end of Q1, we had a total of 25 store-within-a-store concept, which incorporates a smaller footprint pOpshelf store into one of our larger format Dollar General market stores as we continue to be pleased with the results. We are on track to nearly triple the pOpshelf store count this year, as well as open up to 25 store-within-store concepts, which would bring us to a total of more than 150 standalone pOpshelf locations and a total of approximately 50 store-within-a-store concepts by year-end. We continue to anticipate year one annualized sales volumes for pOpshelf locations to be between \$1.7 million and \$2 million per store and expect the initial average gross margin rate for these stores to exceed 40%. Overall, we are very pleased with the results from this unique and differentiated concept, and we are excited about our goal of approximately 1,000 pOpshelf locations by end of 2025. Turning now to DG Fresh, which is a strategic multi-phase shift to self-distribution of frozen and refrigerated goods, along with a focus on driving continued sales growth in these areas. As a reminder, we completed the initial rollout of DG Fresh across the entire chain in 2021 and are now delivering to more than 18,000 stores from 12 facilities. The initial objective of DG Fresh was to reduce product cost on our frozen and refrigerated items and we continue to be very pleased with the savings we are seeing. Another important goal of DG Fresh is to increase sales in our frozen and refrigerated categories. We are pleased with the performance on this front, including enhanced product offerings in stores and strong performance from our perishables department. Looking ahead, we expect to realize additional benefits from DG Fresh, as we continue to optimize our network, further leverage our scale, deliver even wider product selection and build on our multiyear track record of growth in cooler doors and associated sales. And while produce is not included in our initial rollout, we continue to believe that DG Fresh provides a potential path forward to expanding our produce offering to more than 10,000 stores



over time. To that end, we offered produce in more than 2,300 stores at the end of the first quarter, with plans to expand this offering to a total of more than 3,000 stores by the end of 2022. Notably, DG Fresh has also extended the reach of our cooler expansion program. In fact, during Q1, we added more than 17,000 cooler doors across our store base, and we are on track to install more than 65,000 cooler doors in 2022. Importantly, despite the meaningful improvements we have made to date as a result of DG Fresh, we believe we still have significant incremental opportunity to drive additional returns with this initiative in the years ahead. Turning now to an update on our expanded health offering, which consists of up to 30% more feet of selling space and up to 400 additional items as compared to our standard offering. This offering was available in nearly 1,800 stores at the end of Q1, and we are on track to expand to a total of more than 4,000 stores by the end of 2022. Looking ahead, our plans include further expansion of our health offering with the goal of increasing access to basic health care products and ultimately services over time, particularly in rural America. In addition to the gross margin benefits associated with the initiatives I just discussed, we continue to pursue other opportunities to enhance gross margin, including improvements in private brand sales, global sourcing, supply chain efficiencies and shrink reduction. Our second priority is capturing growth opportunities. Our proven high-return, low-risk real estate model has served us well for many years and continues to be a core strength of our business. In the first quarter, we completed more than 800 real estate projects, including 239 new stores, 532 remodels and 32 relocations. For 2022, our plans remain to execute 2,980 real estate projects in total, including 1,110 new stores, 1,750 remodels and 120 store relocations. As a reminder, we expect approximately 800 of our new stores in 2022 to be in our larger 8,500 square foot store format as we respond to our customers' desire for even wider product selection. With about 1,200 square feet of additional selling space compared to a traditional store, these larger formats allow for expanded high-capacity cooler counts, an extended queue line and a broader product assortment, including NCI, our larger health and beauty

offering and produce in many stores. Importantly, we continue to be very pleased with the unit economics of this larger format. While the initial cost to open these larger store is about \$300,000, including fixed assets and working capital, we are seeing increased sales productivity and continue to generate returns in the range of 20% to 22%. In addition to our planned Dollar General and pOpshelf growth in 2022 and included in our total new store goal, we are also very excited about our plans to expand internationally. The goal of opening up to 10 stores in Mexico by the end of 2022. Overall, our real estate pipeline remains robust, with more US brick-and-mortar stores than any retailer, we are excited about our ability to capture significant growth opportunities in the years ahead. Next, our digital initiative, which is an important complement to our physical footprint as we continue to deploy and leverage technology to further enhance convenience and access for customers. Our efforts remain centered around building engagement across our digital properties, including our mobile app. We ended Q1 with more than 4 million monthly active users on the app and expect this number to grow as we look to further enhance our digital offerings. Our partnership with DoorDash continues to yield strong results, as we look to extend the value offering of Dollar General, combined with the convenience of same-day delivery in an hour or less. This offering was available in about 11,000 stores at the end of Q1 and we continue to be pleased with the early results, including better-than-expected customer trial, strong repurchase rates, high levels of sales incrementality and a broadening of our customer base. In addition, we are excited about the continued growth of our Dollar General Media Network, which is becoming increasingly more relevant in connecting our participating brand partners with over 90% of our unique customer base. After establishing the foundation over the last few years, we are poised to meaningfully grow this business in 2022 and beyond, as we expand the program and further enhance the value proposition for customers and brand partners, while increasing the overall net financial benefit for the business. Most recently, we launched a suite of financial offerings, as we look to further leverage our unique footprint to provide our cus-

tomers with additional services they want and need. These services include a spendwell-branded bank account and debit card offering; a buy now, pay later pilot in select number of stores; and a test of a rewards redemption program. These offerings aim to provide greater financial empowerment for customers, while driving incremental traffic and profitability within our stores. Overall, our strategy consists of building a digital ecosystem specifically tailored to provide our customers with an even more convenient, frictionless and personalized shopping experience and we are pleased with the growing engagement we are seeing across our digital properties. Our third operating priority is to leverage and reinforce our position as a low-cost operator. We have a clear and defined process to control spending, which continues to govern our disciplined approach to spending decisions. This zero-based budgeting approach, internally branded as Save to Serve, keeps the customer at the center of all we do, while reinforcing our cost control mindset. Our Fast Track initiative is a great example of this approach, where our goals include increasing labor productivity in our stores, enhancing customer convenience and further improving on-shelf availability. The first phase of Fast Track consisted of both rolltainer and case pack optimization, which has led to the more efficient stocking of our stores. The second component of Fast Track is self-checkout, which provides customers with another flexible and convenient checkout solution, while also driving greater efficiencies for our store associates. Self-checkout was available in more than 8,000 stores at the end of Q1 and we continue to be pleased with our results, including strong customer adoption rates. As a result of the success of self-checkout and popularity with customers, we have recently launched a pilot of stores that are entirely self-checkout. While our associates will remain available to assist customers if needed in these stores, we believe this 100% self-checkout option could further enhance the convenience proposition, while enabling our associates to dedicate even more time to serving customers. We plan to ultimately test this layout in about 200 stores throughout 2022. Looking ahead, we are on track to expand our self-checkout offering to a total of up to 11,000 stores by the end of the year,

as we look to further extend our position as an innovative leader in small-box discount retail. Moving forward, the next phase of Fast Track consists of increasing our utilization of emerging technology and data strategies, which includes putting new digital tools in the hands of our field leaders. When combined with our data-driven inventory management, we believe these efforts will reduce store workload and drive greater efficiencies for our retail associates and leaders. I also want to highlight our growing private fleet, which consisted of more than 950 tractors at the end of Q1 as compared to over 700 tractors at the end of 2021. As a reminder, we are focused on significantly expanding our private fleet in 2022 as we plan to more than double the number of tractors from 2021, which we expect will account for approximately 40% of our outbound transportation fleet by the end of the year. As a result of this planned growth, we believe our private fleet will become an increasingly significant competitive advantage as it gives us greater operational control within our own supply chain, while further optimizing our cost structure. Our underlying principles are to keep the business simple, but move quickly to capture growth opportunities, while controlling expenses and always seeking to be a low-cost operator. Our fourth operating priority is investing in our diverse teams through development, empowerment and inclusion. As a growing retailer, we continue to create new jobs and opportunities for personal and professional development and ultimately, career advancement. To that end, we recently began offering access to 100% employer-paid college degree programs for all full-time employees. In addition, all Dollar General employees and their immediate family members now have access to online, on-demand, self-paced learning platform that provides college level general education courses at no cost to them, which is intended to help initiate or further their education journey and development. These programs are in addition to several other existing development programs, including our fully paid private fleet driver training program, as well as the ability to earn undergraduate credits through the American Council on Education upon completion of our store manager training program. We continue to innovate on additional development opportunities for our teams

to provide ongoing opportunities for career advancement and in turn, meaningful wage growth. Our internal promotion pipeline remains robust as evidenced by internal placement rates of more than 75% at or above the lead sales associate position. Additionally, approximately 15% of our private fleet team began their careers with us in either a store or distribution center. We continue to monitor our competitive position in the market closely and we are pleased with our turnover rates, staffing levels, and applicant flow further validating our belief that we are taking the right actions to attract and retain talent. We believe the opportunity to start and develop a career with a growing and purpose-driven company is a unique competitive advantage and remains our greatest currency in attracting and retaining talent. Overall, we continue to make great progress against our operating priorities and strategic initiatives and we are confident in our plans to drive long-term sustainable growth, while creating meaningful value for our shareholders. In closing, I am proud of the team's strong performance, and we are pleased with our great start to the year. I want to thank our more than 164,000 employees for their hard work as we all focus on fulfilling our mission of serving others every day, and I am excited about our plans for the year ahead. With that, operator, we would now like to open the lines for questions.

### **Operator**

Thank you. At this time, we will be conducting question-and-answer session. — **Operator Instructions** — Our first question comes from Karen Short with Barclays. Please proceed with your question.

### **Karen Short**

Hey, thanks very much. Congratulations on a good quarter.

### **Todd Vasos**

Thank you, Karen.

## **Karen Short**

So, I wanted to just ask, so obviously, your format is very resilient in a weaker macro and should outperform in general, in a weaker macro. But I think investors have been very concerned regarding discretionary risk as it relates to the comp and also to gross margin. So I was wondering, if you could provide a little more color on how your – with respect to your guidance on how you're thinking about comps with respect specifically to discretionary versus non, and then general gross margin outlook as it relates to both categories. Because I mean, my view – my personal view is that, you're obviously a lot more resilient and people realize – or investors realize in terms of both those segments, comps and gross margins. So any color on that would be helpful.

## **John Garratt**

Sure. I'll take that question, Karen. With respect to sales and with both of these, that's obviously factored in with respect to sales, feel very good about the raised guidance that we provided there. We have taken into account that the over performance was really driven by consumables. So that's been factored into the margin as well. So we continue to feel great about both sides of the business, but have reflected the fact that it is more driven by the consumables. And the team has done a fantastic job of proactively adjusting the orders accordingly to minimize markdown risk. The other thing I'll note, just to give a little more color on the shape of the year with regard to sales, the way we see this is as we get past the – now past the stimulus lap that has a significant impact on last year, both with sales, but also it's the most difficult mark – it's the most difficult rather mix lap of the year because they had a disproportionate effect on non-consumables. Now that we're past that, we see a market improvement in our sales throughout the year relatively, even throughout the year and strongly positive. And then, obviously, you don't have as much while we expect a continued mix towards consumables, the lap isn't is significant now that you're past Q1. And again, that's all been reflected.

**Karen Short**

Okay. And then just to clarify, in terms of April, I meant, 2Q off to a strong start. Any more granularity you could provide on that?

**Todd Vasos**

Yes, Karen, we're happy with what – how we ended Q1 and as I indicated in my opening remarks, pretty upbeat on what we have seen in the first few weeks of Q2. And I would tell you, from a consumer perspective, the consumer is behaving intentional in our purchases, I have to say. But in saying that, she still is shopping both sides of the fence, both consumables and non-consumables. And I think that really goes to the value that we have in both consumables and non-consumable side of the business. We've done so much work around that discretionary side with NCI and all the other work that we've done that it's a compelling offering. Even when times are tough for the consumer, she always wants a little bit of an indulgence and we offer that ability at a real low price. So, yes, we feel good about the equation as we move forward, as John indicated.

**Karen Short**

Great. Thank you. Appreciate it.

**Operator**

Our next question comes from Michael Lasser with UBS. Please proceed with your question.

**Michael Lasser**

Good morning. Thanks a lot for taking my question. How much did trade down contribute – or customers trading down, those who may be facing some incremental economic stress, contribute to 1Q? How much have you assumed that will contribute to the rest of the year? And in that vein, how much did like-for-like price increases contribute in the quarter? And how much do you expect it to contribute to the rest of the year?

## **Todd Vasos**

Yes. Thanks for the question, Michael. I'll take that. And I'll tell you that the consumer overall has been fairly resilient through this hyperinflation that we've seen, not only in the products that she has to buy, but the fuel she has to put in her car and other means. So I would tell you that the consumer is holding up well, and it really goes towards what I've talked about all along, and that is as long as she's gainfully employed, that makes the biggest difference in how she shops and gives us that confidence to spend. The great thing at Dollar General is that we offer that value that I just mentioned earlier. And we're already starting to see that our core customers start to shop more intentionally, and we're starting to see that next tier of customers start to shop with us a little bit more as well. Matter of fact, when you look at the COVID customer, I would call it, the one that we attracted and now have retained since COVID, it is still running at or slightly above where we thought we would be right now, and that's a little higher-end consumer. So that tells you that, that trade down and trade in is well and is starting to probably pick up steam as we move through Q2 and into the back part of the year as things continue to tighten up. Lastly, I'll mention is the gas prices. What would normally also occur and we're starting to see if she starts to shop closer to home, not only our core consumer, but that next cohort up, so that trade in that you mentioned, because let's admit it, right, the gas price is at \$4.40, \$4.50 a gallon now on average is keeping her closer to home. So those shopping patterns are definitely changing, and we're seeing it happen right before our eyes.

## **Michael Lasser**

Thank you. And at the risk of being a little bit of a downer, and I apologize for that, one of your big competitors this morning announced they're going to be making some investments to narrow the price gap. Do you think you'll need to take down your prices further and maintain that price gap to continue to enjoy the success that Dollar General has achieved?



**Todd Vasos**

Yes. Michael, I would tell you, we look at all competitors when we look at our price, and there's some much bigger competitors out there than the one that you are referring to, that we watch really closely. The great thing is, is that our prices are right in our historical ranges, and we feel great about price. We've got plenty of ammunition to do whatever we need to do. But I would tell you that we've never felt better about our price position as we continue to move through Q2 and into the back half of the year. We've taken the opportunity, and I've mentioned this before, over the many, many months of – through COVID, to sharpen our prices even more. And I believe that what we're seeing right now, against all classes of trade would tell you that Dollar General is in a great spot and has all of the levers that is disposable to continue to keep that positioning. We don't see anything on the horizon that gives us any concern there at all.

**Michael Lasser**

Thank you very much. Good luck.

**Todd Vasos**

Sure.

**Operator**

Our next question comes from Matthew Boss with JPMorgan. Please proceed with your question.

**Matthew Boss**

Thanks. And congrats on another nice quarter.

**Todd Vasos**

Thank you.

**Matthew Boss**

So, Todd, on value and convenience, it seems like this is really the key driver that you're citing as one of the main pieces to the continued momentum in the business. I guess, how much do you attribute all of this to company-specific topline drivers? What initiatives do you think that you're the most excited about that still have legs? And then more so, as we think about the back half of the year, help us to think about the in-stock opportunity or other key drivers of the business on a year-over-year basis?

### **Todd Vasos**

Yes, Matt, thanks for the question. I would tell you that our initiatives continue to push forward and also drive that topline. So, if you think of DG Fresh, that continues to be our top driver. But one area that we have started to talk about recently, and we'll continue to hear more and more about is our digital initiative. And I would tell you that, that digital initiative will continue to help propel that topline as well. It's driving not only our current customer, but a different cohort of customer into Dollar General. And that is that, cohort that is a little bit more digitally savvy. We have spent some nice capital over the many years, building the platform for this. And really, in earnest, in the last six to eight months, have really turned the dial up on moving that digital piece. So, while others are worried about fixing fundamentals, we're really moving the needle forward on a lot of those big initiatives. So, you think of DG Fresh, self-distribution of produce coming up in our supply chain as well, you think about digital. And then, of course, we're so excited still about NCI and pOpshelf. pOpshelf is performing very well, even in a climate that one would consider the non-consumable discretionary side of the business may be challenged. But pOpshelf continues to do well. That's what gives us a lot of confidence as we move forward into the upcoming months and years ahead. So, we've got a tremendous amount of drivers, a lot more than value and convenience. But when they come into the store through all these other means that we're driving traffic into the store, they are definitely gravitating to value and convenience because everybody loves a deal.

## **Matthew Boss**

Great. And then, John, maybe on the gross margin. How best to think about the build for the second quarter and the back half of the year relative to the first quarter. And just with that, if we think larger picture and maybe similar to my topline question, what inning would you say the company-specific benefits that you've seen from DG Fresh, NCI, maybe the private fleet, what inning are these in today as we think about margin benefits?

## **John Garratt**

Sure. Great questions, Matt. I'll start with the first part of the question, just around how we're looking at gross margin, I'll start by saying, we're very pleased with what we've been able to do to hang on to that gross margin goodness. While we were down about 1.5 points this quarter, we were lapping over two points of expansion last year. And if you go back to pre-pandemic levels, we're still one point above where we were. I think it really speaks to the impact of the initiatives. Now certainly, there are some near-term pressures that we called out. We talked about on the call, the pressure from supply chain costs, which were an \$85 million year-over-year headwind. Now that was down from Q4, which was \$100 million. The other thing that we talked about was the LIFO provision of \$61 million that we booked based on the anticipated inflation for the full year. And of course, we had the mix challenge. But again, as I mentioned before, much more pronounced in Q1 as we lap the significant impact of stimulus. So as we look forward, I mentioned, we expect continued mix pressure on a year-over-year basis, not as much as we saw in Q1 as we get away from stimulus. We also expect continued pressure from supply chain, fuel costs as well as product cost inflation. However, we expect it to improve as we move through the year. The lapse ease, particularly in the second half of the year as we lap the very heavy inflation from last year. And we anticipate some moderation. We're seeing some moderation in the cost pressures, due in part to the benefits of the initiatives and the cost reduction actions we've put in place. We mentioned the private fleet. We're going to double that in size this year as we convert tractors and trailers in-house that

drives 20% savings. And we've done other actions to lock in more third-party capacity to manage our inventory very well, adjust to the changing demand of the customers. So we feel we're very well positioned. And as we look ahead, we're not giving specific guidance on gross margin, but we expect EPS to improve sequentially as we go from quarter-to-quarter throughout the year for the reasons I mentioned and really see ourselves as you look at, again, scaling impact of the initiatives you mentioned, we're in early innings there. They vary, but I would say in macro, we're probably on average, third, fourth inning in most of these, on average, both in terms of the sales benefit as well as the gross margin benefit. So as these scale and as we work the other levers we've talked about, as we leverage our scale and as Todd mentioned, is we're in a very good place in price. We see ourselves in a very nice position to, over time, continue enhancing our gross margins.

**Matthew Boss**

Great color. Congrats again.

**John Garratt**

Thank you.

**Operator**

Our next question is from Simeon Gutman with Morgan Stanley. Please proceed with your question.

**Simeon Gutman**

Good morning, everyone. John, I have a follow-up to that question. It's on overall margin or incremental margins. I think you spoke to gross. So this was embedded in the guidance even when you issued it in the fourth quarter that you have the step-up in incremental margin sequentially throughout the year. Sales get better, but if you look at the incremental against the sales, it's still an above average rate for what this business has done historically. So I heard some of the commentary that you just said within the gross and

why that gets better. But it seems like cost pressures that were present three months ago, maybe getting worse, not better? And then how do you reconcile that versus accelerating incremental throughout the year?

**John Garratt**

No, I wouldn't say we see cost pressures getting worse. We mentioned the cadence around the inflation. I would say the moderation is going to be more gradual than originally thought, but we still are seeing moderation. We still expect moderation, and that's why we see that sequential improvement in EPS and overall margins as we move through the year. In terms of SG&A, we don't see any increased cost pressure there in terms of wage inflation. We've talked about that. We expect that growth in wage inflation to be well less than prior year, a little more than pre-pandemic levels, but still manageable, and it's tracking where we expected there. We also mentioned making some targeted investments and specifically labor hours. It's really from a position of strength to continue driving the sales momentum to make sure we're good for the customer in terms of in-stock levels and customer experience, but not a material step up there. So we feel very good about the guidance we provided, maintaining the full year EPS guidance despite enhanced, as everyone has called out, inflationary pressures. I think the team has done a great job mitigating those and improving the in-stocks in the right categories to be ready to drive the top line and the bottom line.

**Simeon Gutman**

And Todd mentioned that there's some tightening that's happening, that the maybe trade down is starting to pick up steam. Are you willing to share – was that – that was that built into your plan? Are you seeing it happen quicker than the way your plan was built?

**Todd Vasos**

Yes. I would tell you that some of it was built in. We knew that the consumer was going to

get tighter in 2022, just because of the lack of stimulus compared to last year. But I would tell you that because of other pressures, more inflation coming through on her everyday needs as well as that fuel that I talked about, has quickened the pace a little bit. So we believe that she'll flee even further to value as she moves into the back half of the year, especially as she gets to that holiday time frame, I believe that you'll see that. So we're very prepared for that. The last thing I'll also mention that shows us that she is starting to move that way a little quicker is, one is, she's coming more often in those basket, unit sizes are a little bit smaller. That's the true sign and also the \$1 price point that we are really pushing and getting behind has really accelerated as well, and we're seeing that. So that would tell you that she's trying to make ends meet, and we'll be there for her because that's what we do best.

**Simeon Gutman**

Thanks, guys. Good luck.

**Operator**

Our next question is from John Heinbockel with Guggenheim Partners. Please proceed with your question.

**John Heinbockel**

Hey, Todd, maybe start with, right, the business is in a far better place than it was in 2008 and 2009, right? We did extremely well. How does the recession playbook look differently than back then in terms of – and how quickly do you play that? What do you have to see to want to lean into that playbook?

**Todd Vasos**

Yes. John, it's a good question, and thanks for that. I would tell you that we're in a much different spot, not only economically, meaning the consumer is in a little different spot here. And I think the biggest piece is that employment is still very healthy across all co-

ports of customers that we serve. So I think that's one of the big differences here than 2008, 2009. Now could that roll over? We're watching that, very well could, which would then just quicken the pace that flight to value. But we haven't that yet. But because of the other inflationary pieces we have seen. So there really isn't a lean-in in the playbook as much as it is knowing what that customer is going to do from historical times and then servicing I mentioned. And the reason we're leaning into that \$1 price point is because we know how important that is during those times. Private brand, we've seen an acceleration in our private brand business as well in recent weeks. That's a true sign that she's starting to feel that pressure. So how do we respond? Well, you'll see more end caps, more off-shelf displays of both \$1 and private brand as we move through Q2 and then to the back half of the year. So we're really good and nimble, as you know, and to be able to move very quickly, so you'll see more and more of that. I think the important thing here is we're so different as a company than we were in 2008, 2009. I would hate to be fixing fundamentals right now because the opportunity to gain share is going to be tremendous as we, I believe, move through this year. And we're so far beyond that with all of the initiatives that we've put in place over the last six, seven years. It's nice to see that we're going to be in a position to take an oversized amount of share, we believe, as we move through the back half of the year.

### **John Heinbockel**

And then maybe secondly, right, on your – the health and beauty assortment, maybe it's too early to tell. But when you look at those items in the basket or the people who are buying them, what are you seeing, right, in terms of frequency of shop, basket size, co-purchases and that's typically a very loyal customer? Do you think that will drive more frequency? Is that the primary benefit you think you'll see?

### **Jeff Owen**

Hey, John, this is Jeff, and thank you for that question. As we think about health, we've

been saying this for quite some time, the largest share donor we're seeing in our business certainly is from the drug channel. And so that's one of the reasons as you've heard us say before, why we're leaning in here. And so certainly with 30% more selling space and 400 additional items, we're really pleased to be in 1,800 stores and being 4,000 by the end of the year. And what we're seeing in the customer's response is very good. And we're excited about what we're seeing not only in our take rates, but also when you break down the basket. So when you think about Dollar General, I think the best way to think about this is this way. When you look at our mainstays, like home cleaning and paper where we have closer to a 10 share, and when you think about this particular area when we're closer to a four, it really paints the opportunity for us to continue to grow share in this particular area. And as we've said before, we do classify this as consumable, but it has margins that are akin more to non-consumable. And when you step back and you think about the larger footprint that we talk about, where 80% of our stores in 2022 will be in that larger 8,500 square foot footprint, it gives us the full theater to put this in place. So I think you see from why we're so excited, but also, I think you see the intentional nature of how we layer this into our strategic view of the business and how we look forward and around the corner. So I think you'll see more to come there. We're really excited about what we see.

**John Heinbockel**

Thank you very much.

**Operator**

Our next question is from Rupesh Parikh with Oppenheimer. Please proceed with your question.

**Rupesh Parikh**

Good morning. Thanks for taking my questions. So I had two questions on the inflation



front. So first, what are you seeing right now from a product cost inflation perspective? And then second, are you – are there any challenges you're seeing right now passing through some of the higher prices?

### **Todd Vasos**

Hi Rupesh, this is Todd. Real quickly, obviously, we've seen what others have seen on that. We're a little different spot though and our product mix is much different than the broader retail spectrum. So I would tell you that we're seeing, on average, a lot less cost pressure than what you would find in retail in general. That's number one. The second piece is we have the ability here to trade off items and to trade down sizes, which we've been very active over the last six, eight months on, when we saw inflation starting to move in a little different direction. So we've got the ability to do that. That's what we do best on our merch side. And so we've done a lot of that to also push off some of those costs to the consumer. But as it relates to when we do have to put costs out there, I'm sorry, additional retail to cover some of that CPG cost, we've been able to do that because we do it the Dollar General way, right? And we make sure that we can layer it in where the consumer still knows and sees the value of what we offer. And again, as I mentioned in my earlier comment, we haven't felt better about where we are. We're right in historical levels of our pricing indexes compared to all classes of trade. So, I believe we've got the ability to pass on where we need to. But more importantly, to help defray some of that pass on to the consumer through our category management efforts, which, again, we're probably one of the best in the industry on.

### **Rupesh Parikh**

Great. And then maybe just one follow-up question. Just on your discretionary categories, just given many of the concerns out there, did anything differ versus your expectations during the quarter? I know weather did have an impact potentially on some of the categories. But just curious if you've seen any changes in consumer behavior within those

discretionary categories?

**Todd Vasos**

Yes. As I mentioned also a little earlier, the consumer is becoming more and more intentional in our purchases. We've seen that. And what that means is taking care of our family a little bit more on the consumable side of the business, where she needs to make sure she buys. And then on that discretionary side, obviously, tightening the belt a little bit. So, yes, we saw that. We knew that was going to occur just because of the stimulus lap. But as I also mentioned, we saw it probably accelerated a little faster than where we thought it would as well. But the great thing is the buying team has been all over this. So, what we're already doing is as we see the – with the third and fourth quarter and be able to yet adjust, we're able to go in and adjust the products that we're selling on that discretionary side as well as making sure that the prices are right on the discretionary side, especially as we get to the important fourth quarter selling season. So, we feel like we've seen where that consumer is probably going to land on a mix basis, discretionary versus non, but we also believe we've made the right trade-offs and as John indicated, feel real good about our inventory levels there and not concerned at all at this point on any markdown risk that may be there.

**Rupesh Parikh**

Okay, great. Thank you.

**Todd Vasos**

Sure.

**Operator**

Our next question is from Kate McShane with Goldman Sachs. Please proceed with your question.

**Kate McShane**

Thanks for taking our question. Our first question was just around the SNAP benefit, just how the SNAP composition has changed at DG over the last couple of quarters and what your projection is for the rest of the year?

**John Garratt**

Yes. It continues to be elevated over pre-pandemic levels. The Thrifty Food Plan is still a benefit there. And while you have some states pulling out of the emergency waivers, it's been very gradual. And so, it's still mixing quite a bit higher than norm, just not at the same peak level it was in middle of last year, but doing very well there, continue to gain share with that customer and serve them very well.

**Kate McShane**

Question is just about traffic. Is there an expectation of when you think that can inflect positively?

**Todd Vasos**

Yes. I would tell you that, we actually closed out Q1 with a positive traffic number, which was really good to see. And as I indicated in my opening comments, like what we see on our start to Q2, and I think you can actually take from that, that our traffic number is looking much better than it was. So we feel, as we get further and further away from that stimulus lap that John referred to, we believe we've got the right products, initiatives, price points, especially in this environment to drive that traffic long term.

**Kate McShane**

Thank you.

**Todd Vasos**

Absolutely.

## **Operator**

Our final question comes from Corey Tarlowe with Jefferies. Please proceed with your question.

## **Corey Tarlowe**

Hi. Good morning and thank you for taking my questions. Firstly, on international, as it relates to Mexico, can you provide an update as to where you are on progress for expansion into that region?

## **Jeff Owen**

Thanks, Corey. This is Jeff. So in Mexico, I'm really pleased with what the team has been able to accomplish in a relatively short period of time. I would tell you, we have assembled a fantastic team of retailers and folks are really excited about joining the opportunity. So first and foremost, the team is incredibly impressive with decades of experience. That's the first point. The second point is, is that we continue to make great progress around learning how to serve this customer. And as we've mentioned before, we have a lot of analogs that gave us great confidence to even expand internationally from a lot of the performance and customers we serve along the board, which we've done historically incredibly well here at Dollar General. So as we learn more and more about that consumer, we're really excited about what we are able to offer her and tailor it to her needs and also really rely a lot on what we've been able to do so well here in the United States. So I feel great about the assortment and the build that we're doing there. Feel real, good about the supply chain progress. And then also on the real estate, in fact, we've been down there a couple of weeks ago and headed down there here shortly to continue to look at the sites and been very pleased with what we're seeing in terms of our ability to be convenient and be that community serving retailer that we are here in the US and excited about what we're going to be able to do in Mexico. And we still feel real good about our initial expectation of up to 10 stores by the end of the year.

**Corey Tarlowe**

That's great. And then just a follow-up question for John. As it relates to capital allocation, how are you thinking about the balance sheet and cash levels balancing the dividend close to \$3 billion in share repurchases and then \$1.5 billion in CapEx?

**John Garratt**

Yes. We're still thinking about the same way in terms of the priorities. Our first priority remains investing in the business. When you can get these kind of returns on new stores and the kind of returns we're getting on our strategic initiative that positions us so well, that's where we're going to continue to invest first. Then it's paying a competitive dividend, which we increased 31% year-over-year on a quarterly basis. And then the business generates a tremendous amount of cash, which allows us to buy back shares. And as you mentioned, we're going to target \$2.75 billion this year. So really, meaningfully investing in the business, meaningfully returning cash to shareholders in these forms. And in terms of CapEx with these kind of returns, we're going to invest what we need to. But again, I think with that amount, we're doing quite a bit with it. It is up a little bit as a percent of sales from historical norms. But the biggest piece of that is just still inflation. And so, if you strip that out, it's kind of back down to that historical level of a little over 3% of our sales. So, we feel really good about the allocation. It's working very well for us. And I think working very well for the investors.

**Corey Tarlowe**

Very helpful. Thank you very much and best of luck.

**John Garratt**

Thank you.

**Todd Vasos**

Well, thank you for all the questions, and thanks for your interest in Dollar General. I'm

proud of our team, which continues to execute at a high level for our customers every day. I'm sure you can tell, I'm more excited about this business than ever before. We are a mature retailer in growth mode, and our strategic focus has differentiated us in a discount retail landscape, particularly as we have transformed this company in the last few years. As a result, I believe we are very well positioned to capitalize on the enormous growth opportunities we see in front of us. Thank you for listening, and I hope you have a great day. Thank you.

### **Operator**

This concludes today's conference. You may disconnect your lines at this time, and we thank you for your participation.

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