Dollar Tree: Family Dollar Store Analysis

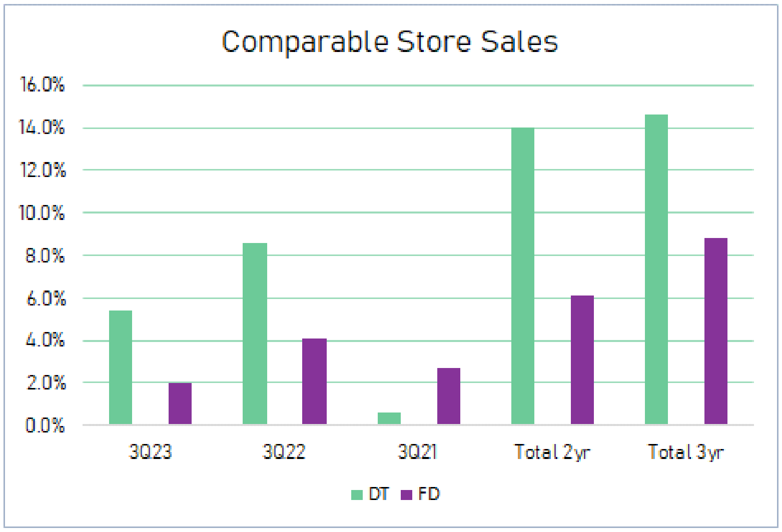
Key Takeaways

1	Dollar Tree initiated a strategic review of its Family Dollar fleet. The Company intends to provide an update on this review no later than its 4Q23 conference call in March.
2	As of October 28, 2023, the Company operated 16,622 stores total, with 8,272 namesake locations and 8,350 Family Dollar stores.
3	According to RetailStat's data, 64% of Family Dollar locations are within three miles of a Dollar Tree store.
4	The aggressive expansion of dollar stores into low-income communities is likely resulting in market saturation, price competition and ultimately necessitate the evaluation of the FD banner.

During its 3Q conference call, Dollar Tree (DT) disclosed that it had initiated a strategic review of its Family Dollar (FD) Portfolio. The review aims to address the issue of unprofitable locations, which may lead to the rebannering, closing, or sale of certain stores. Despite DT eliciting headlines and perhaps emotions with its "strategic review" comment regarding its FD portfolio in November 2023, DT has actively pursued strategic initiatives to optimize the FD banner since its $9 billion acquisition in July 2015. This sequence of strategic moves commenced with the introduction of its:

- H2 format at its FD banner in 2019. The H2 format introduced DT $1 merchandise sections, an expanded party assortment, and an expanded number of freezer and cooler doors.

- In March 2021, DT introduced its combo store layout which unified the DT and FD brands within a single storefront. These stores cater to the needs of small towns and rural communities with populations ranging from 3,000 to 4,000 residents, areas that often lack extensive retail variety. At the end of 1Q23, the Company had roughly 4,610 H2 stores and 975 combo stores.

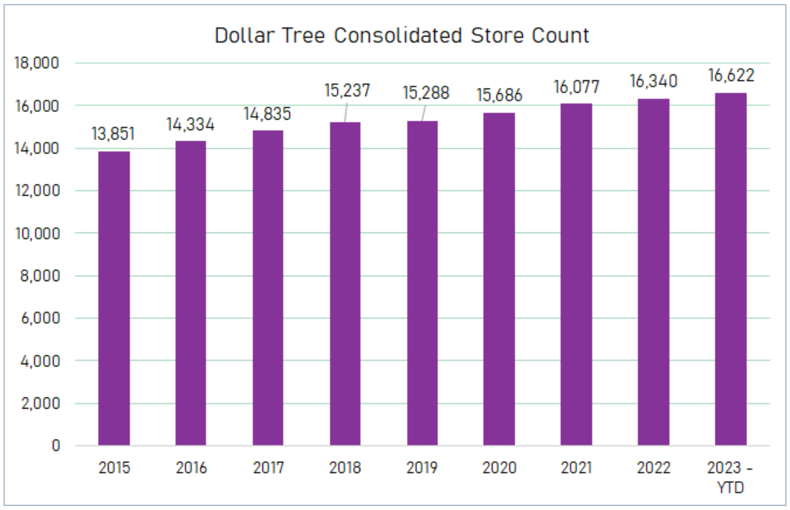


- In 3Q22, the Company introduced a newer version of its H2 format, H2.5, which includes deeper shelving, increased linear footage, increased beverage offerings, and frozen food assortments. The FD banner had roughly 830 H2.5 locations by the end of 2Q23 and management plans to complete a total of 1,200 conversions by FYE23.

- Additionally, the Company recently introduced two new initiatives: the Rural format and the Extra Small Box (XSB) format. The Rural format is an updated version of the Company's traditional combo stores, enhancing the range of frozen and refrigerated products. While the XSB format infuses elements from the H2.5 format along with a broader seasonal offering, into smaller retail locations. It features shelving to 78-inches, enabling the Company to refurbish hundreds of smaller, previously untouched stores. Moreover, DT has added adult beverages to its FD banners to improve sales volumes further; as of 1Q23, it has more than 3,150 stores (more than 38%) selling these beverages.

Despite these efforts, when comparing both banners, DT outperformed the FD banner on a two-and-three-year stacked basis and Dollar General (DG), FD's top competitor, has outperformed FD.

- DT has averaged approximately 355 new store openings per fiscal year (ex. YTD23), apart from just 51 in fiscal 2019.
- During that time, the Company announced the closure of 390 FD locations, renovation of at least 1,000 stores, and rebranding of another 200 to DT banners, all in an effort to optimize the banner.
- In YTD23, across both banners, the Company has opened 422 stores and closed 135, resulting in a net opening of 282.

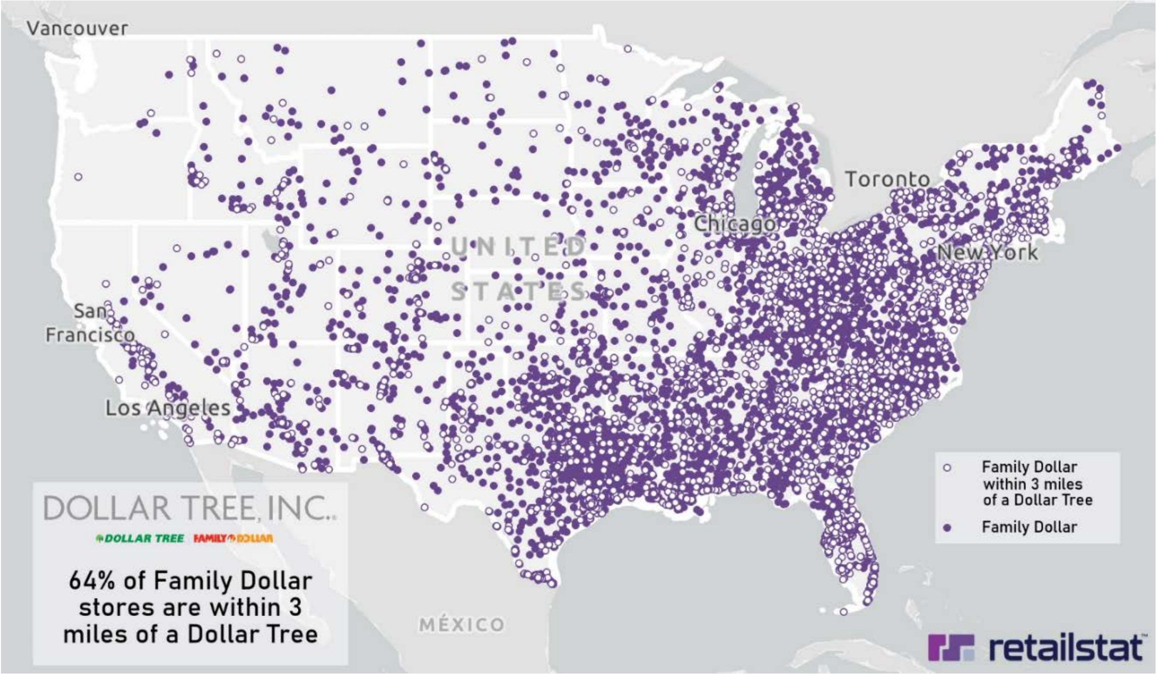


The financial performance of the FD brand has been notably underwhelming this fiscal year. A significant factor contributing to this slump is the reduction in SNAP benefits, which has heavily impacted the brand's core demographic of lower-income consumers who prefer the convenience and price-point of FD over Walmart and grocery outlets. As of YTD23, consumables have comprised approximately 81% of the FD's banner total sales, in contrast to 48% at the DT banner. However, It's important to note, that the FD brand does not exist in isolation. Its primary competitor, DG, has maintained an aggressive expansion strategy, opening an estimated 900 to 1,000 new stores annually.

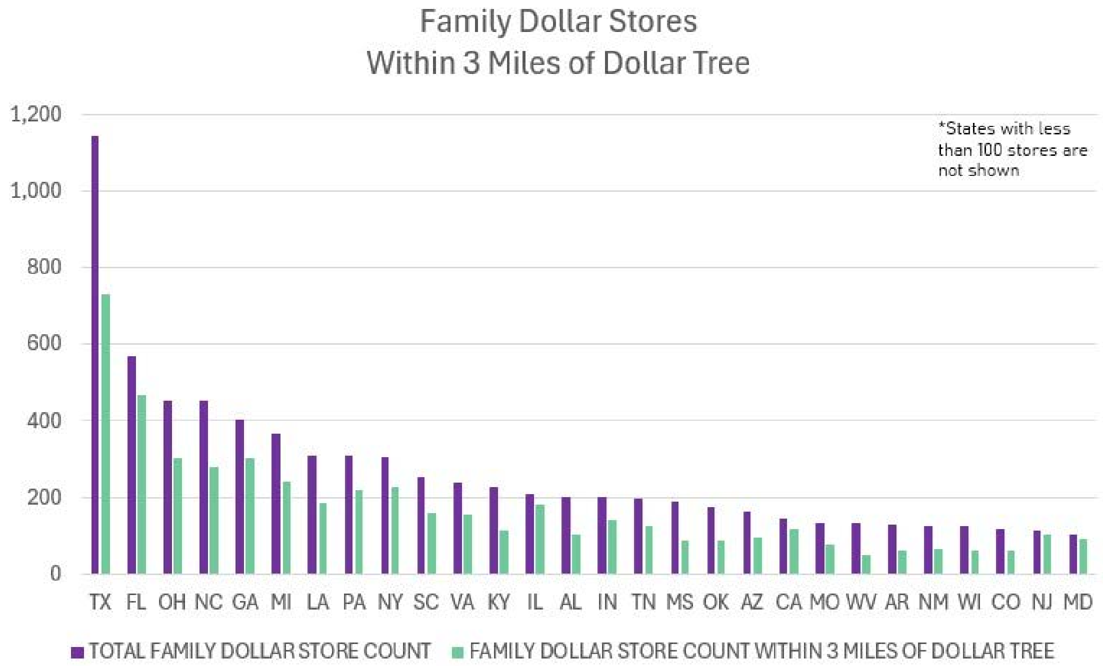
Like FD, DG has taken note of the challenges facing consumers. At Goldman Sachs annual global retailing conference on September 13, 2023, CEO Todd Vasos of DG acknowledged the strain on shoppers, "It really showed up in mid-March where the SNAP reductions and the tax refund lowering or in some cases didn't get one at all, really had a pressure–put pressure on our consumer as she's still battling the inflationary pressures, even though it's moderating. It certainly on a two-year stack is still significant for our consumer." In a strategic shift, DG is planning to slow down its pace of new store openings to 800 in FY24. This deceleration is attributed to the increased costs associated with opening new locations and a strategic decision to prioritize improving operations within existing stores.

> "To maximize value creation, we need to periodically reevaluate our portfolio in terms of current market conditions, individual store performance and overall portfolio considerations. To this end, we have initiated a comprehensive review of our Family Dollar portfolio to address underperforming stores that are not aligned with our transformative vision for the company. This will involve, among other things, identifying stores as candidates for closure, rebannering or relocation with the goal of ensuring that each assets under the Family Dollar banner is delivering its full value for our shareholders on a sustainable basis."
>
> CEO Richard Dreiling commenting on the Family Dollar Portfolio

Store Overlap Analysis – Click Here To Request Store Overlap List



Based on RetailStat's data, it has been observed that 64% of FD stores are within a three-mile radius of a DT location. Out of the 8,350 existing Family Dollar stores, the five states with the largest concentration are Texas, Florida, Ohio, North Carolina and Georgia.



In recent years, rural and urban areas have experienced a growing presence of dollar stores, including DG, which has aggressively expanded with about 5,000 new stores over the last five years. Consequently, FD is likely losing market share to DG, as both operators target the same demographics, providing a diverse range of merchandise, such as groceries, household goods, apparel, beauty products, and other essential items.

As of YTD23, DG and FD saw discretionary items account for just 18.7% and 19.5% of total sales, respectively. This escalating market saturation is likely a contributing factor in management's evaluation regarding the future of FD's store network.

In stark contrast, the appeal of the DT banner primarily resonates with middle-income shoppers, who shop for unique non-food items—an experience management noted as "the thrill of the treasure hunt" in its stores. Furthermore, recent insights from 3Q23 revealed that the DT banner's comparable sales growth was largely attributed to an influx of new consumers within the last year, including noticeable interest from households earning above $125,000. This indicates that consumers with higher incomes are increasingly choosing DT's more cost-effective options for essential purchases.

> There will be some stores that will relocate, maybe some stores will close, maybe some stores will rebanner. But I do not have any of that information at this stage of the game. I've always prided myself on being transparent, and all I'm trying to do is tell the world we're taking a look at it. And I do think it's prudent.
>
> And I do think -- I don't want anyone to misconstrue that I'm not totally behind Family Dollar because I am. And I don't want anyone to think that, that doesn't mean we're not going to grow Family Dollar because I'm not saying that at all. It's simply a matter of reallocating assets to where we think we can be more productive.

CEO Richard Dreiling commenting on the Company's commitment to Family Dollar

Recap

While DT is currently reevaluating its FD banner, the Company has generally performed well and outperformed its counterpart, DG, throughout fiscal 2023. In 3Q23, DT's consolidated net sales increased 5.4%, while enterprise-wide comps were up 3.9%; DT and FD saw comp gains of 5.4% and 2%, respectively. The FD banner saw its comps deteriorate in the back half of 3Q, along with its average ticket turning negative in October, as its low-income consumers faced increased financial pressure due to the cumulative impact of inflation and the expiration of expanded emergency SNAP benefits in early 2023. This compares to DG, posting 3Q23 sales gains of 2.4% with a comp decline of 1.3%.

(Gross)	Sales Per Square Foot	Average Sales Per Store
Dollar Tree: 3Q Ended 10/28/2023	$45 (+5%)	$490K (+7%)
Dollar Tree: Fiscal Year Ended 1/28/2023	$175 (+6%)	$1.9 million (+9%)
Family Dollar: 3Q Ended 10/28/2023	$43 (0%)	$400K (+3%)
Family Dollar: Fiscal Year Ended 1/28/2023	$175 (0%)	$1.6 million (+3%)
Dollar General: 3Q Ended 11/03/2023	$53 (-4%)	$490K (-4%)
Dollar General: Fiscal Year Ended 2/3/2023	$220 (+5%)	$2.1 million (+5%)

Given the prevailing consumer trends as well as the expiration of expanded SNAP benefits, we anticipate ongoing obstacles for the FD brand and DG. Meanwhile, the DT brand will likely maintain its growth as higher-income consumers continue to trade down for everday essentials. Despite management already pruning 50 or so FD locations annually, DT executives will probably further shutter a meaningful number of FD locations, although the exact figure remains uncertain. That said, although store rationalization is likely on the radar, FD is not taking its foot off the pedal with future expansion. Looking forward, both businesses are intent on expansion; as noted earlier, Dollar General is set to open 800 new locations in FY24. Although DT has not disclosed specific plans for the next fiscal year, they have communicated an intent to continue growing, with 600 to 650 new stores planned for the current fiscal year across both banners. Over the past three fiscal years, on average, the Company has opened about 500 new stores and closed 150 stores across both banners.

However, the broader objective for these dollar retailers isn't just to compete with one another but to capture a larger slice of the total retail market by drawing customers from traditional grocery stores, big-box retailers like Walmart, drugstores, and even convenience stores. This is evidenced by expanding its aforementioned product offerings, including groceries, fresh produce, healthcare items, and adult beverages. At the same time, DT and FD stores are geographically accessible to shoppers, with 87% of their customer base located within five miles of a store. DG is similarly convenient, with roughly 80% of its stores in communities of 20,000 or fewer residents.

Overall, 2024 is set to be a time of re-balancing for these discount operators, as they balance ongoing growth ambitions, and massive unit growth, with a challenging consumer environment impacting profitability and short-term strategic planning. DT management stated it would provide further insights into the evaluation of its FD fleet no later than its fourth-quarter conference call in March 2024. RetailStat will be closely monitoring store base plans and report any store-level updates through our [Retail Openings and Closings (ROC)] platform.

Taylor Ricketts, Vice President
(800) 789-0123, ext. 139

Robert Altun, Jr. Analyst II
(800) 789-0123, ext. 182