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Dollar Tree: Finally reaping the rewards of Family Dollar acquisition

by Yong Kit Siong

Dollar Tree, the biggest US dollar-store chain, recently reported a 109% increase in YoY profit. Along with a boosted forecast for next quarter's earnings, the company's shares rose as much as 11%. In July 2015, the discount retailer became the largest dollar-store chain in the United States after successfully acquiring Family Dollar in a protracted bidding war with rival Dollar General Corporation.

After its acquisition, Dollar Tree implemented a series of restructuring activities at Family Dollar including refurbishment of the stores and improvement of the product assortment and customer service. The chief executive of Dollar Tree, Bob Sasser, claimed greater operating efficiency at Family Dollar, which helped to boost margins. In an effort to reduce costs, Dollar Tree also announced 370 job cuts at Family Dollar in August this year, striving to eliminate redundancies in the business.

Subsequently, Dollar Tree used best practices across both organizations to try to deliver cost synergies, aiming to reduce the combined company's annual expenses by USD 300mn over three years. Dollar Tree stressed that improved product selection at Family Dollar was a priority in making the chain more profitable due to low-margin consumable products like food and high-margin discretionary products like clothing. In the latest quarterly report, the company seemed to have achieved part of its cost-synergizing plan as it listed lower merchandise and freight costs as contributing factors to better earnings.

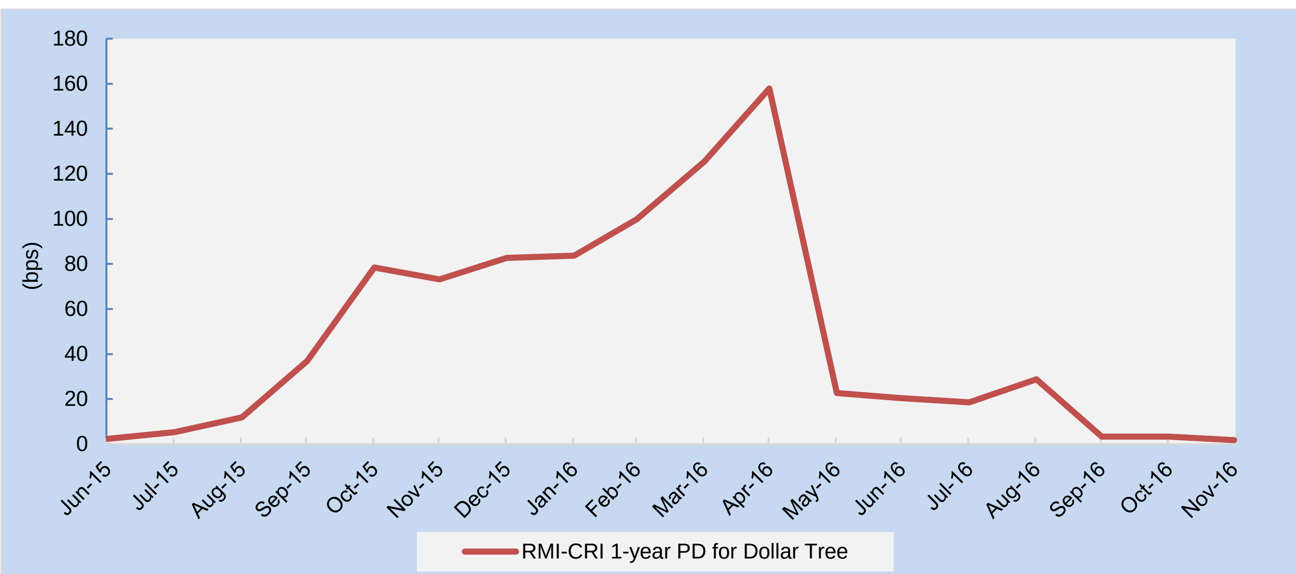

Figure 1: RMI-CRI 1-year PD for Dollar Tree Inc. *Source: RMI-CRI*

As shown in Figure 1, since its merger with Family dollar in July 2015, the RMI-CRI 1-year Probability of Default (PD) for Dollar Tree had been increasing until April this year. The increase in 1-year PD for Dollar Tree coincided with disappointing business performance, which saw same-store sales growth slow for the fourth consecutive quarter in January 2016. The sluggish sales were a consequence of unusually warm weather that adversely affected demand for cold-weather items and also aggressive discounting on merchandise by retailers.

Subsequently, Dollar Tree reported significantly better sales metrics for the quarter ending 30 April 2016. The company cited overhead cost improvement and acquisition of Family Dollar as reasons for the rise in sales. In the most recent quarter, the company continued meaningful progress in its integration with Family Dollar, as stores became cleaner, values were greater and customer feedback scores regarding merchandise assortments improved.

As shown in Table 1, the Return on Equity of Dollar Tree has been steadily increasing since November 2015, suggesting better profitability of the business. Apart from that, the company is also much less leveraged than the previous quarters as Net Debt to Earnings before Tax, Depreciation, Amortization (EBITDA) has been on a downward trend, reaching 2.83x in the latest reported quarter. Total Debt to Total Equity has also dropped consistently since it acquired Family Dollar, reflecting the better ratings outlook for the firm.

3 Months Ending	10/31/2015	01/30/2016	04/30/2016	07/30/2016	10/29/2016
Same-store Sales Growth (%)	2.10	1.70	2.30	1.20	1.70
Return on Equity (%)	9.08	9.12	13.63	16.03	17.49
Total Debt/ Total Equity (%)	201.43	166.70	156.98	150.33	140.34
Net Debt/EBITDA (x)	5.46	4.31	3.50	2.90	2.83

Table 1: Financial data for Dollar Tree Inc. *Source: Bloomberg*

In recent years, Dollar Tree has also been expanding aggressively, gaining market share from Wal-Mart stores due to its business advantages of smaller store sizes, improved product assortment and prices that start at USD 1.00. Looking ahead, the company expects encouraging business prospects as it makes continued progress in building the foundation for a “larger, stronger, and more profitable” Family Dollar business. As the holiday selling season is coming up, the company claims that it is well-positioned to efficiently serve more customers in more markets. Lastly, with a lightened debt load and boosted profitability, it appears that Dollar Tree has successfully executed its integration plan after acquiring Family Dollar.

Credit News

Bumi Resources hopes to boost coal production as debts restructure

Dec 3. Bumi Resources, the largest thermal coal miner in Indonesia, plans to boost coal production next year after a successful debt restructuring scheme following a recent increase in global coal prices. The debt restructuring scheme includes a debt-equity swap at a premium price of IDR 926.16 apiece, more than three times its stock price on 28th November, when the Jakarta Commercial Court ratified the company’s debt-restructuring proposal. The company is looking to produce up to 100 million tons of coal in 2017, twice the figure 10 years ago. Presently, Bumi’s biggest coal importers are India and Japan, which make up for 25 percent and 15 percent, respectively, of its total coal production. (The Jakarta Post)

HCC board approves debt restructuring plan

Dec 3. The board of the Hindustan Construction Company (HCC) has agreed to the company’s plan to issue equity shares and optionally convertible debentures under the Reserve Bank of India (RBI)’s S4A scheme for sustainable restructuring of shared assets. The S4A allows lenders to separate sustainable debt (debt serviceable from existing cash flows) from unsustainable debt, and issue equity conversion options for unsustainable debt. The issuance of 251,992,670 shares represents 24.44% of the expanded share capital of the company. The company has INR 5,000cr (about USD 73mn) of standalone debt, and INR 10,000cr (about USD 146mn) of consolidated debt. (Business Standard)

Dubai's Drydocks said to ask 80% write-off on USD 1.4bn loan

Nov 30. Drydocks World LLC, controlled by state-owned Dubai World has requested creditors to write-off 80 percent of a USD 1.4bn loan. The firm is offering to pay 20 cents to the dollar in cash on the 15-year loan it agreed with lenders 4 years ago. The Middle East's biggest shipyard is reorganizing debt for the second time after a 2012 agreement to reorganize USD 2.25bn of loans – joining the club of other state-owned firms that delayed debt payments amidst frozen credit markets and asset price slumps during the global financial crisis. The company is also seeking to raise a further USD 800mn in 2017 to replace an existing facility agreed with banks in 2012. (Bloomberg)

Italian banks hold nearly a third of euro zone's bad loans

Nov 29. According to European Central Bank data, 29 Italian banks are holding nearly a third of the EUR 990bn euros of unpaid loans at top euro zone lenders. Mounting bad loans and a legacy of the financial crisis are curbing fresh lending and undermining confidence in the banking system. Italian banks have already set aside reserves equal to 44.6 percent of all their bad debt, a higher 'coverage ratio' than other countries with high levels of unpaid loans such as Cyprus and Portugal. The ECB has already handed out targets for reducing the amount of bad loans to troubled banks in the region. (Reuters)

Turkish firms loaded with foreign debt fear rate rises

Nov 29. With Donald trump's victory, investors were spooked over the effect of an unexpected rise in US interest rates on Turkey, a country that is heavily dependent on foreign finance. Over the past decade, Turkish companies have been ramping up foreign currency debt at a pace second only to that of China. According to Turkey's central bank, Turkish companies had foreign currency liabilities of about USD 210bn at the end of September. Central bank data indicated that the "rollover ratio" for Turkey's corporate sector was more than 160% in the first nine months of this year – i.e. for every USD100 due companies borrowed USD100 again along with an additional USD60. (FT)

Euro slips with Asian stocks while bonds rise as Italy votes no (Bloomberg)

Global bonds suffer worst monthly meltdown as USD 1.7tn lost (Bloomberg)

Bennu Oil & Gas files for Chapter 7 bankruptcy in Texas (WSJ)

Regulatory Updates

US banks face clash over EU regulations

Dec 4. The EU's eleventh hour amendment to the latest set of European banking regulations has been met with warnings from US banks of their inability to comply. The objection to the EU's latest banking regulations, which states that foreign banks must combine their business in the bloc into a separately capitalized subsidiary or holding company, was on the basis that it goes against existing US regulations. While the measure was expected to come under fire from banks which are most affected by the new regulations, European policymakers did not foresee the reason why the banks argued that the proposals would be impossible for them to comply with would be the limits placed on combining the investment banking activities of their broker dealers with their commercial and retail operations in a single structure below their parent company. (FT)

RBS biggest failure in Bank of England stress test

Nov 30. The Royal Bank of Scotland (RBS) fared the worst in the BOE's stress test of UK's seven largest lenders, meant to simulate a house price crash in the UK and a global recession. The 73% state-owned RBS needs to bolster its balance sheet by GBP 2bn by shedding assets, cutting costs and reducing risk-weighted assets. The stress test, which is running for the third year, found that Standard Chartered and Barclays also missed one key metric each. The stress test simulates a hypothetical 31% fall in house prices, coupled with hypothetical falls in oil prices, GDP contractions and unemployment rate rises. (BBC)

China regulator slams leveraged stock acquirers as 'robbers' (Bloomberg)

US banks' regulator seeks to oversee fintech groups (FT)

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