

HollAnd

Advisors

Holland Views – Dollar Tree – Price: \$81; M Cap: \$19,295m

A cash compounding colossus

We believe we have found a new business with almost all of the traits we look for. It is also in or near our sweet spot, being a great compounder but with an easy to understand value consumer proposition. It has a history of great returns and has excellent capital allocation credentials.

US-based ultra-discount retailer Dollar Tree, we conclude, has three angles of value that attract us to its shares. These are:

1. It is a simple business with a long track record, excellent longstanding management and operates in a duopoly with a high market share.
2. It looks undervalued against the quality of its business model, cash generating capacity and growth potential.
3. Its owner earnings (cash) we think are 25% above the reported net income. Further, its reported earnings are possibly under earning today as 50% of its sales might well see a longer term margin recovery.

We have looked closely at this company for some weeks now. The sizable (game-changing) acquisition by Dollar Tree of its competitor Family Dollar in 2015 makes assessing *the trend* of the company's past achievements a little harder to analyse (but far from impossible). However, it is the long-lasting effects of that acquisition that throw up today's opportunity in the possibly depressed margins and returns and the depressed share rating vs. peers that has resulted.

Before this acquisition in 2015, Dollar Tree was a compounding colossus, growing organically and generated prodigious amounts of cash in the process. As a sweetener to encourage you to read on, we disclose in Fig.1 below that Dollar Tree's Book value per share compounded at 13% pa in the 15 years to 2014 notwithstanding that, over the same time, an average c.78% of annual net income was returned to shareholders. Square that!!

We think this could be an exceptional investment offering some compelling long-term cash compounding to investors prepared to study.

Fig.1: A hell of a track record

1998-2014	\$m
Average ROE	26%
Cumulative Reported Net Income	4,753
Cumulative Capital Returned to shareholders	-3,698
aggregate capital return as % of Net Income	78%
BVPS cagr	13%
Holland est of Cumulative 'Owner Earnings'	6,032
as % of Net Income	127%

Source: Bloomberg, Holland Advisors

This report is split into three sections

1. The first gives a pictorial view of this sub-sector showing the attractive traits that it possesses and how the stock market considers it favourably.
2. The second looks at Dollar Tree and seeks to show it as a better/or a least as good an operator as its peers despite a much lower share rating.
3. Lastly, we look at the prodigious cash generation this company has now produced for 20 years. Our analysis showing how annual owner earnings are 25% above reported Net Income.

First, a refresher on the qualitative attributes we seek – A company should:

- Seek to deliver excellence to customers and treat/train its employees well to ensure industry-leading products and drive long term loyalty of the product or service offered.
- Make the high returns that we are all attracted to and also be primed to maximise growth opportunities.
- Have Management who are open and honest about the opportunities, business drivers and hurdles in their industry. They should also express clarity in understanding what type of company it seeks to be in order to maximise shareholder value.
- Know how to use shareholder capital as wisely as possible for all types of expansion or efficient balance sheet structure.

Mr Market ‘gets’ that Dollar Stores – in scale – are a great model

The ultra-discount ‘dollar store’ retail market in the US is comprised almost entirely of three brands, Dollar General, Dollar Tree and Family Dollar. Dollar Tree acquired Family Dollar in 2015. Dollar Tree has remained a true \$1 store – everything costs a dollar - the other two brands sell multi-priced assortments.

Fig.2: Three brands now within a market duopoly



Source: Fortune.com

Post Dollar Tree’s acquisition of Family Dollar it now has 14,800 stores (under its two brands) across the US, its main rival Dollar General has 14,500. Whilst industry data is not easy to come by we estimate today that these two have c.80-90% market share of the dollar store format in the US (competitors mentioned are Fred’s and Five Below but only have twelve hundred stores between them). In Canada a sizable operation has also been built by Dollarama of c.1200 stores.

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

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