
Competitor Snapshot

Discount Stores

July 16, 2014

YCharts' Competitor Snapshots are designed to provide an overview of the relative valuation, valuation metrics and drivers, and competitive environment for a group of companies. These reports are designed to provide background information and competitive color for a company that is the subject of a future Focus Report. This report precedes a Focus Report on Target [TGT](#).

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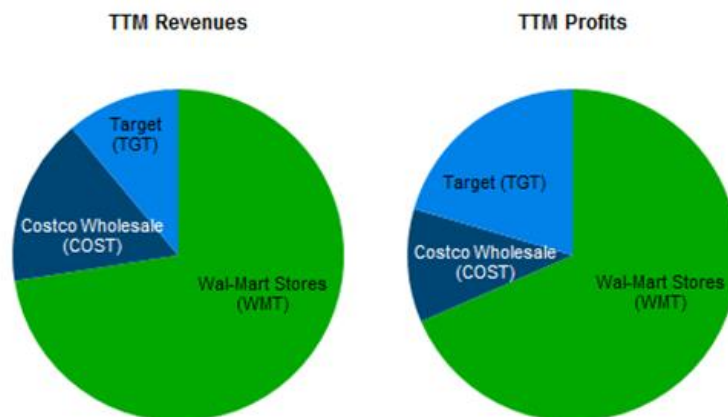
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Competitive Summary

Discount Stores

Target is the third largest company in the Discount Stores industry by revenues and the second largest by profits. The other two heavyweights obviously being Wal-Mart [WMT](#) and Costco [COST](#). Together, in this report, we call these firms the Big 3. Target's revenues are over four times as great as the next biggest firm in the industry, Dollar General [DG](#).



The divisions below are a bit simplistic, but in general, the industry splits itself up along the following lines (see also company descriptions in the Appendix on page 9):

1. Supercenter discounters: Wal-Mart and Target
2. Membership warehouses: Costco, PriceSmart, and Sam's Club (owned by Wal-Mart)
3. Local discounter / Extreme value: Dollar General, Dollar Tree, Family Dollar, and Fred's
4. Closeout: Big Lots, Burlington Stores, Tuesday Morning

All discounters must compete on price, which means economies of scale becomes crucial to success. Wal-Mart is the king of scale economies, whose logistic systems and laser-like focus on cost cutting has allowed it to become the dominant bricks-and-mortar retailer in the U.S. and a force to be reckoned with in overseas markets as well. It's stores are destinations in and of themselves. Parking lots as large as air fields and double-wide shopping carts are meant to encourage suburban residents to travel to their stores and do a week's worth of shopping at one go. How can another retailer compete against economies of scale offered by Wal-Mart?

Target positions itself as more upscale and fashionable than Wal-Mart and has been successful in generating higher profit margins with this strategy. Costco and other warehouse retailers concentrate on a much more limited number of products (or "SKUs" as they are termed in the retail world), but sell them in bulk and combine inventory storage space with display space. Local discounters have been successful in targeting clients in areas that are not suited to the Big 3's siting criteria—rural areas, communities with lower average incomes, etc. This group has found success not by being the once a week shopping destination, but rather being smaller, more convenient, and less confusing (with fewer SKUs). Closeout retailers perform an important inventory function for larger traditional retailers—buying last season's inventory excess for pennies (or dimes) on the dollar and marking them up for sale to their own customers. This allows prominent retailers to generate sales through discounting without destroying brand cachet by looking as though they are discounting.

Note that Burlington Stores [BURL](#) was only listed in 2013 after it was brought back to the public markets by its leveraged buyout owner Bain Capital. To present a consistent aggregate operational picture of the industry, we have left Burlington data out of our time series graphs in this report.

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All data in this report was collected using the YCharts Screener, Data Tables, and Excel Add-In.

* NOTES

- We exclude stocks trading on Canadian exchanges and on the illiquid US exchanges (Pink Sheets and Bulletin Board). ADRs traded on a major exchange are included in our data, so our aggregate market capitalization numbers will differ from those published by Standard & Poors, Russell, and other index providers.
- We use the Morningstar Sector classification system that differs from the GICS system published by Standard & Poors. The main difference between the two systems is that Morningstar sector classifications split Real Estate out as a sector separate from Financial Services.

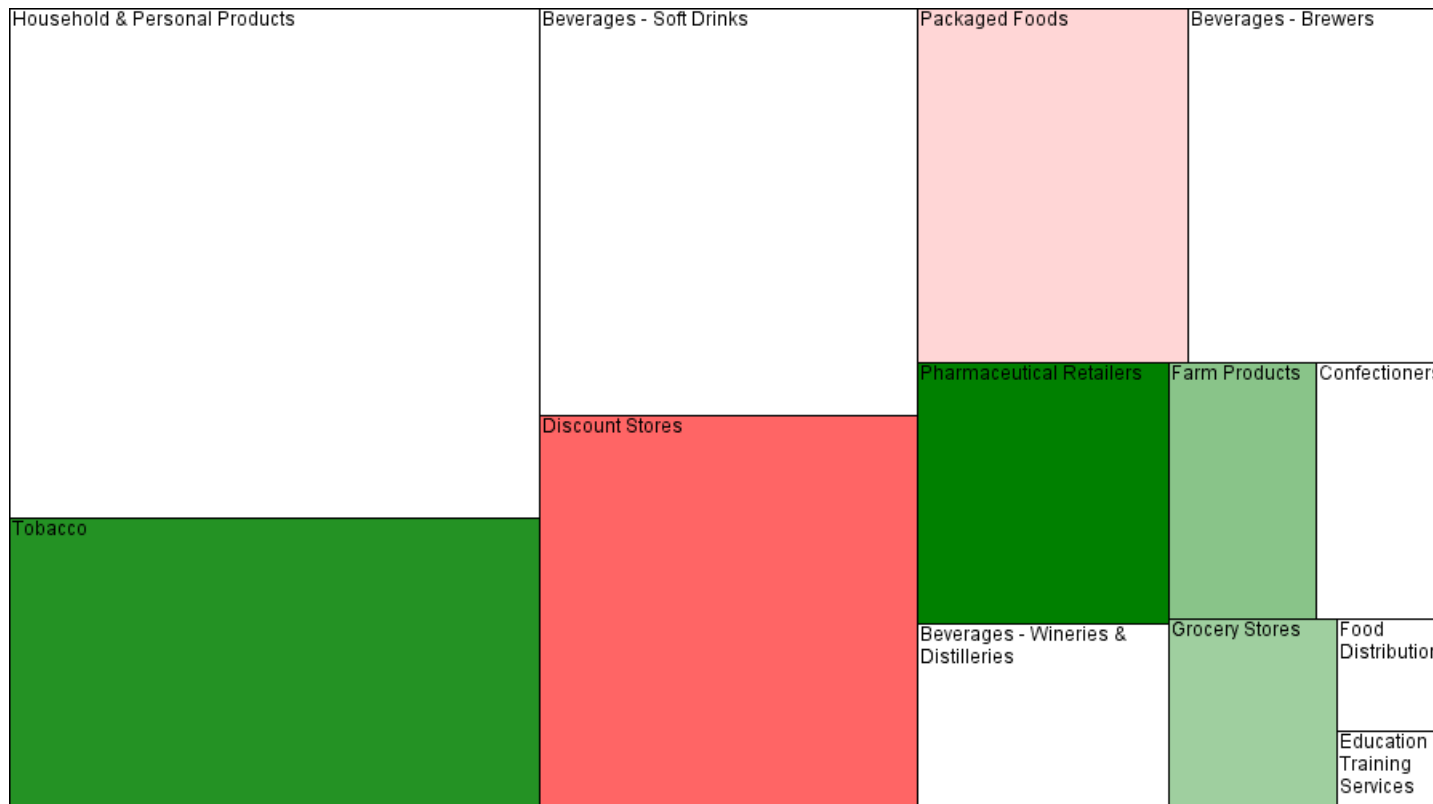
Consumer Defensive Sector

Market Capitalization represented by box size

Bull/Bear Score represented by box color

For more information about the Bull/Bear Score, see our [10% Report Methodology Document](#).

YCharts subscribers can [click here](#) to see all data for US Consumer Defensive stocks. Non-subscribers, please [contact us](#) for these data.



Consumer Defensive Sector	
Aggregate Market Cap (\$T)	3.08
Market Cap / TTM Sales	1.29
Market Cap / Book Value	4.43
Leverage Factor	2.76
ROE	22%
OCP Margin	5%
Dividends % OCP	61%
Dividend Yield	2%

Largest Stocks	Industry	Market Cap	1 Year Total Returns	Value Score
Wal-Mart Stores (WMT)	Discount Stores	247,089	2%	8
Procter & Gamble (PG)	Household & Personal Products	217,992	5%	8
Coca-Cola (KO)	Beverages - Soft Drinks	184,334	7%	7
Anheuser-Busch InBev (BUD)	Beverages - Brewers	183,701	31%	9
Unilever (UL)	Household & Personal Products	137,783	15%	7
PepsiCo (PEP)	Beverages - Soft Drinks	136,035	13%	8
Philip Morris (PM)	Tobacco	135,724	2%	9
Unilever (UN)	Household & Personal Products	131,885	13%	9
British American Tobacco (BTI)	Tobacco	114,438	20%	9
Ambev (ABEV)	Beverages - Brewers	112,013	3%	NA

Discount Stores Industry

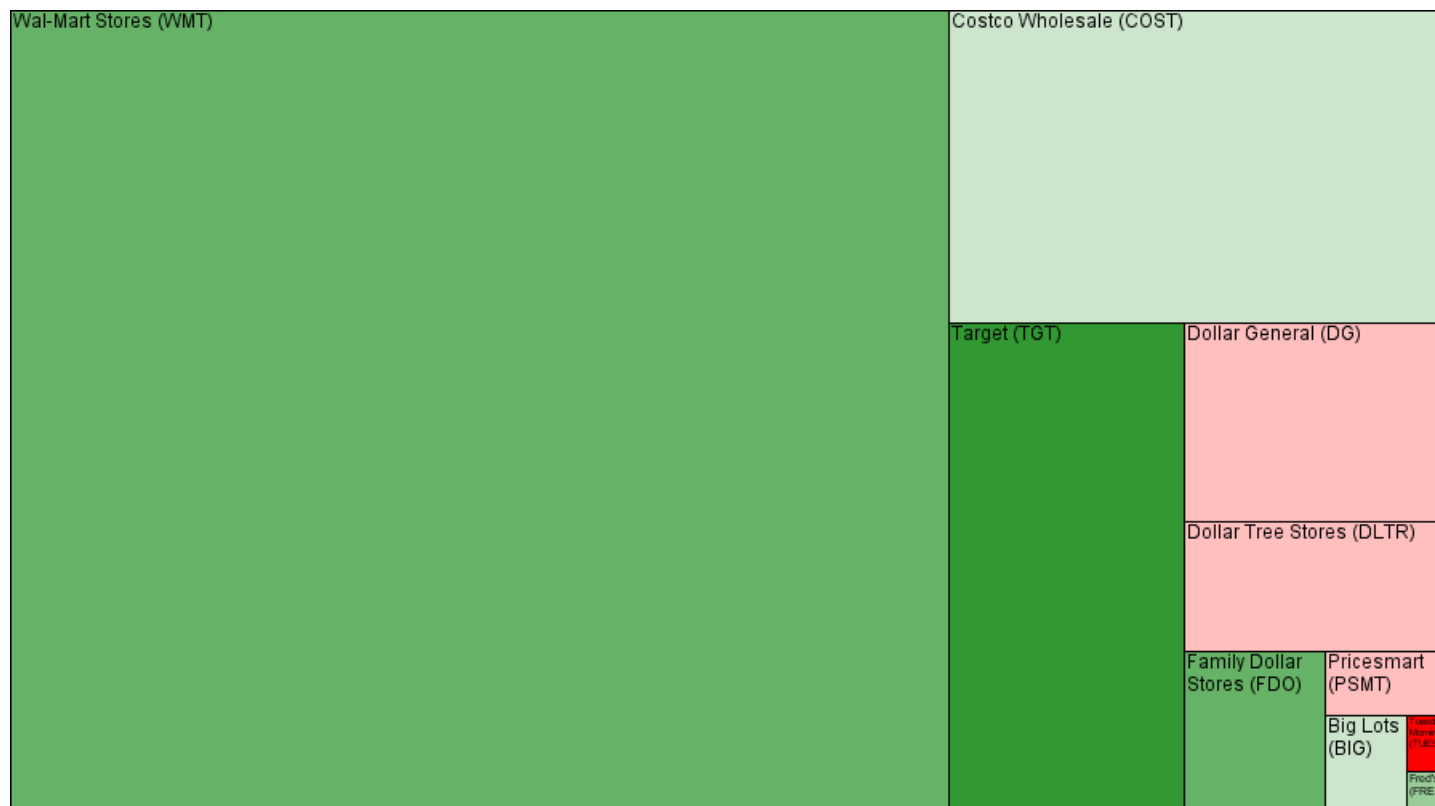
Industry Overview

Market Capitalization represented by box size

Value Score represented by box color

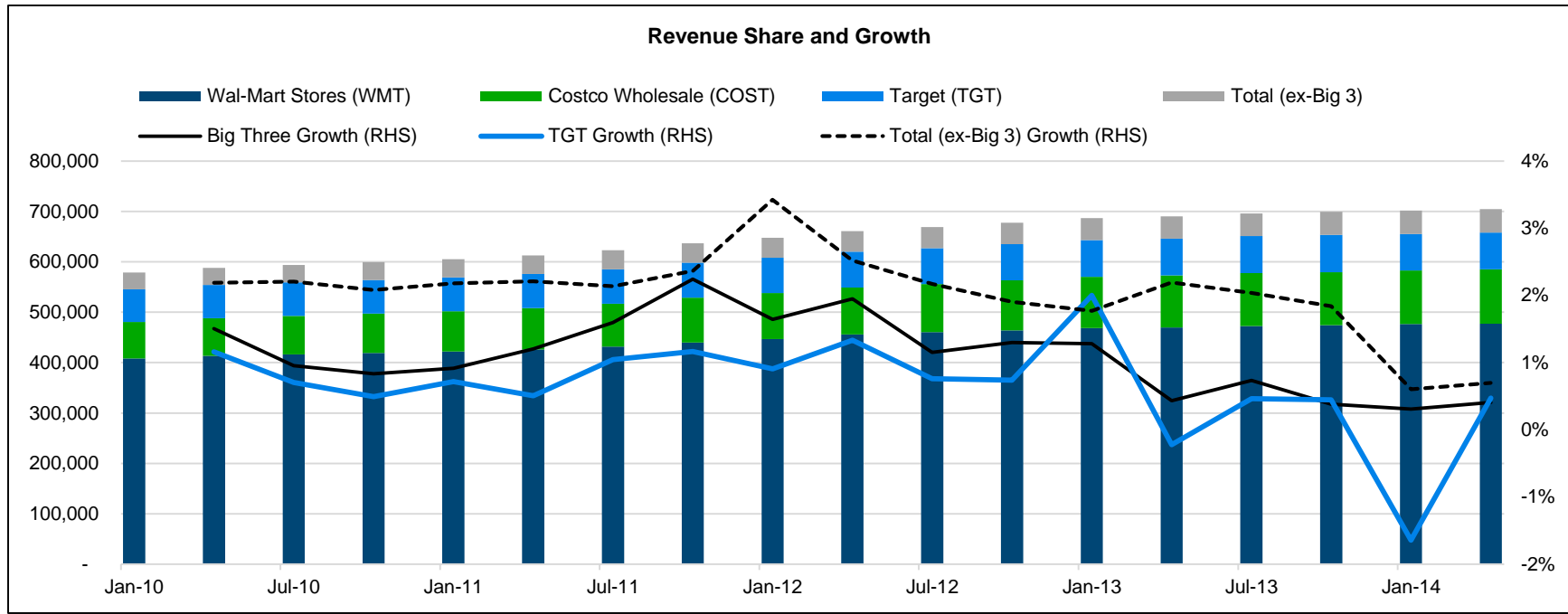
For more information about the YCharts Value Score, see our [Big Picture report](#).

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Consumer Defensive Sector	
Aggregate Market Cap (\$B)	381.3
Market Cap / TTM Sales	0.5
Market Cap / Book Value	3.4
Leverage Factor	2.7
ROE	20%
OCP Margin	3%
Dividends % OCP	40%
Dividend Yield	2%

Largest Stocks	Market Cap	1 Year Total Returns	Value Score
Wal-Mart Stores (WMT)	247,089	2%	8
Costco Wholesale (COST)	51,482	5%	6
Target (TGT)	37,896	-14%	9
Dollar General (DG)	17,398	10%	4
Dollar Tree Stores (DLTR)	11,373	4%	4
Family Dollar Stores (FDO)	7,328	2%	8
Pricesmart (PSMT)	2,624	-3%	4
Big Lots (BIG)	2,505	34%	6
Burlington Stores (BURL)	2,229	NA	NA
Tuesday Morning (TUES)	781	60%	1



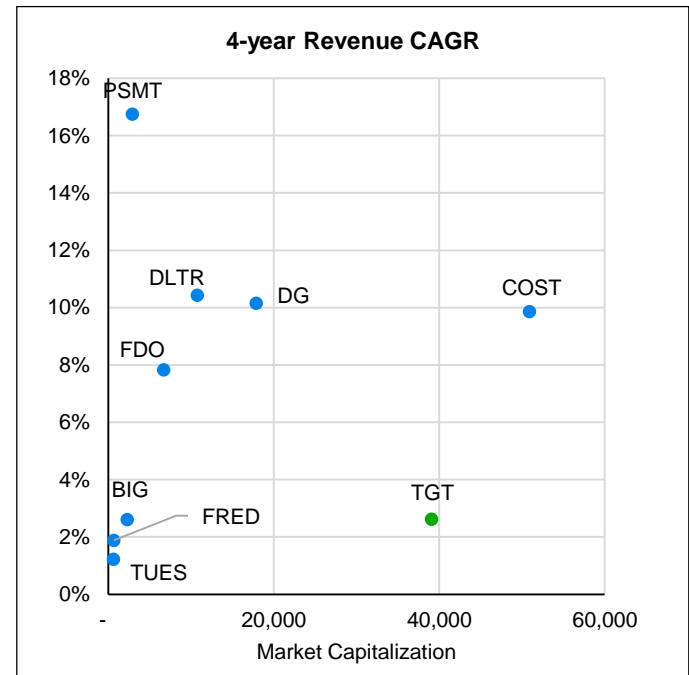
Note that the Revenue Share and Growth chart tracks the amount of trailing twelve-month (TTM) revenues and percentage growth in successive quarters. The 4-year Revenue CAGR chart shows the compound annual growth rate (CAGR) from the aggregate TTM revenues in January 2010 to the aggregate TTM revenues to April, 2014.

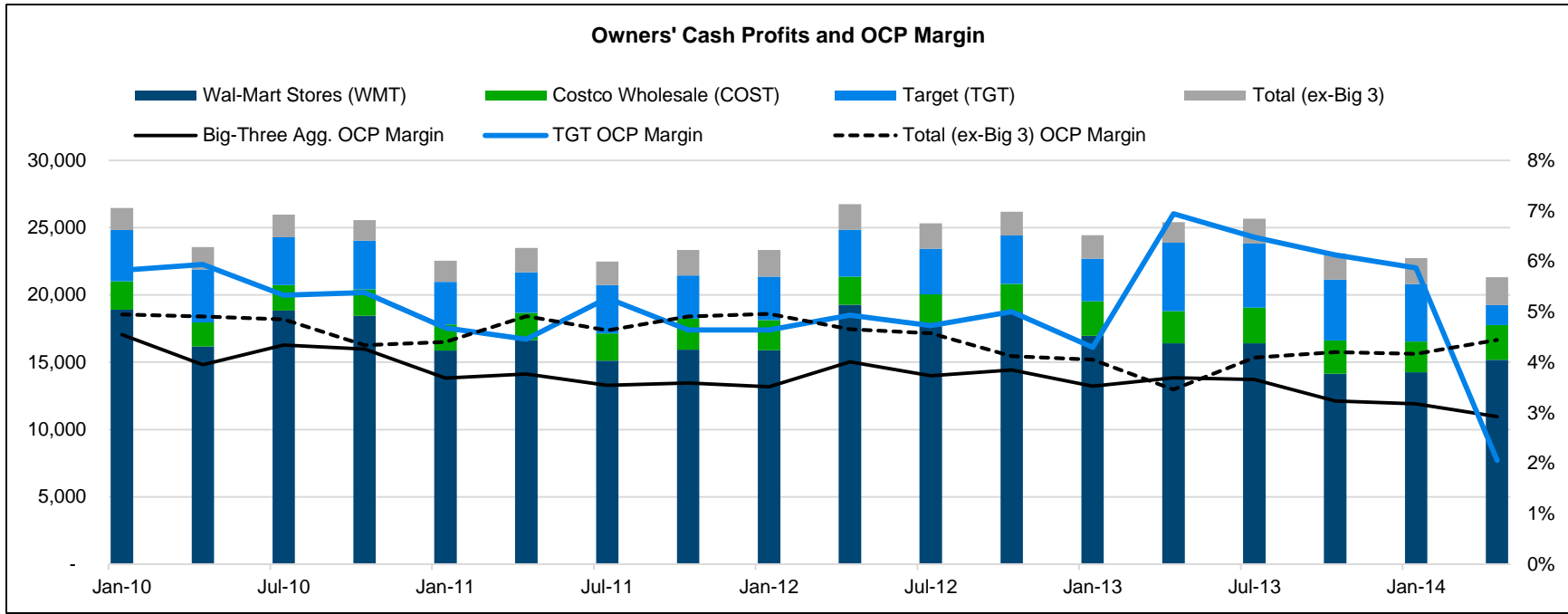
For clarity's sake, we did not plot Wal-Mart on the market cap versus revenue growth chart, but its CAGR over the time period covered has been 3.8%.

The revenue growth standout shown on the 4-year Revenue CAGR chart is PriceSmart [PSMT](#), which is likely not a familiar name to many U.S. investors. PriceSmart runs a chain of membership warehouse stores in Latin America and the Caribbean. A 1994 spin-off from Costco [COST](#), PriceSmart's stores and business strategy appear similar to those of its former parent, but locations are smaller and located overseas. Headquarters are in San Diego, CA.

The large rise in total revenue growth (ex- Big 3) in January 2012 was mainly due to strong results from Dollar General [DG](#), the largest of the non-Big 3 competitors. Part of this notable uptick is an artifact of the data—there was one more week in the TTM period ended in January than in the TTM period ended in the previous quarter. Not all of the increase was a result of this however; DG's earnings release mentions increases in both sales volume and average transaction value.

The huge dip in Target's revenues in January 2014 was due to the credit card security breach. The drop in the growth rate for ex-Big 3 firms during that same period was largely due to a 1.7% decline at Family Dollar Stores [FDO](#), whose announcement attributed the weakness to bad weather during the holiday shopping season and to a client base that was more financially strapped during this holiday season compared to the last.



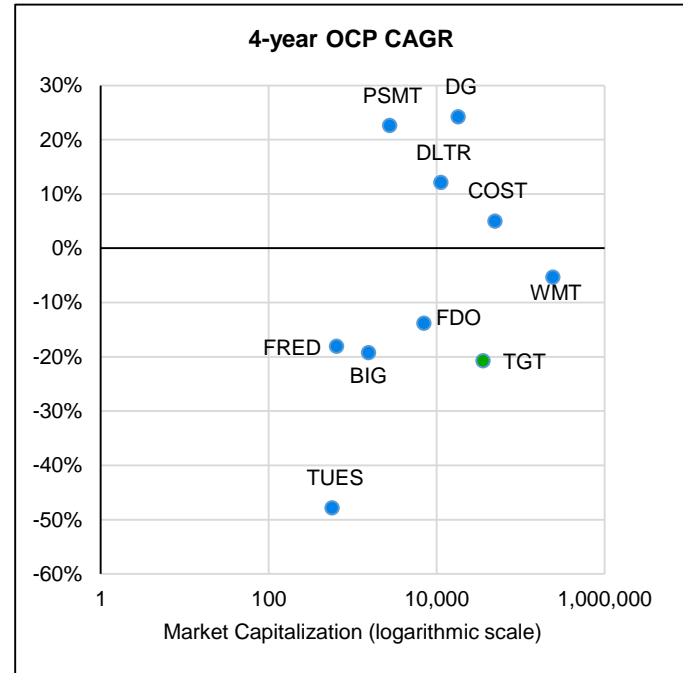


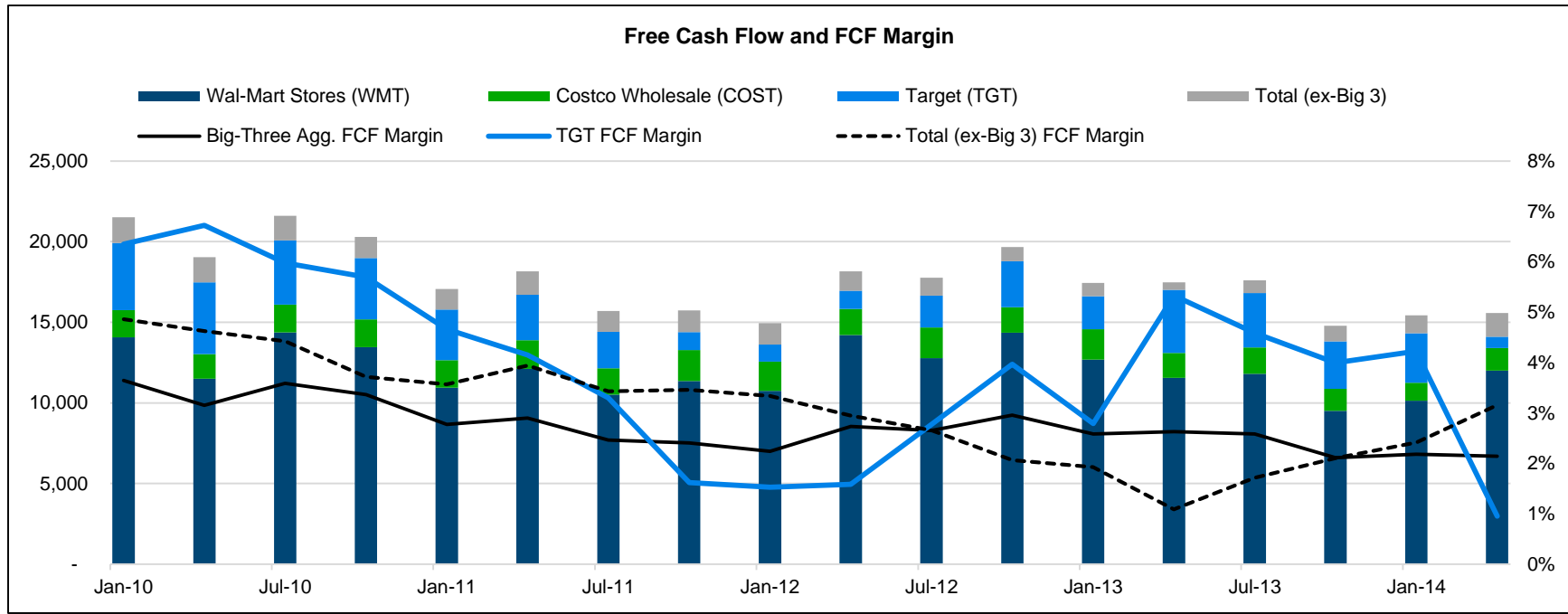
Owners' Cash Profit (OCP) is YCharts' preferred metric for assessing a firm's profitability. OCP is equal to Cash Flows from Operations less an estimate of cash needed for maintenance capital expenditures. For a full discussion of OCP and a related metric—Free Cash Flow to Owners (FCFO)—please see our [Focus Report Methodology Document](#).

The most notable facet of the graph above is the jump in Target's profit margin during the April quarter of 2013 and the precipitous fall in April 2014. We take a closer look at the root cause behind this change in profitability levels in the Focus Report on Target.

In general, it is obvious that profitability in this industry fluctuates in the mid-single digit percentage of revenues range. Average profitability at the smaller stores (the non-Big 3 chains) tend to be higher than those of the Big 3. Big 3 profitability is propped up by Target's margins. With roughly half of Wal-Mart's revenues coming from low-margin grocery items and Costco built on a model of providing cut-rate products in bulk quantities, it is no wonder Big 3 profitability is low, on average.

Another interesting thing to note is the slippage in Wal-Mart's absolute profitability over this period. TTM profits recorded in the time period ended in October 2013 were 20% lower than the profits generated in the TTM period ended in October 2010. Note also that even with the drop in profitability, Wal-Mart's share of total industry profits is still over 70%.



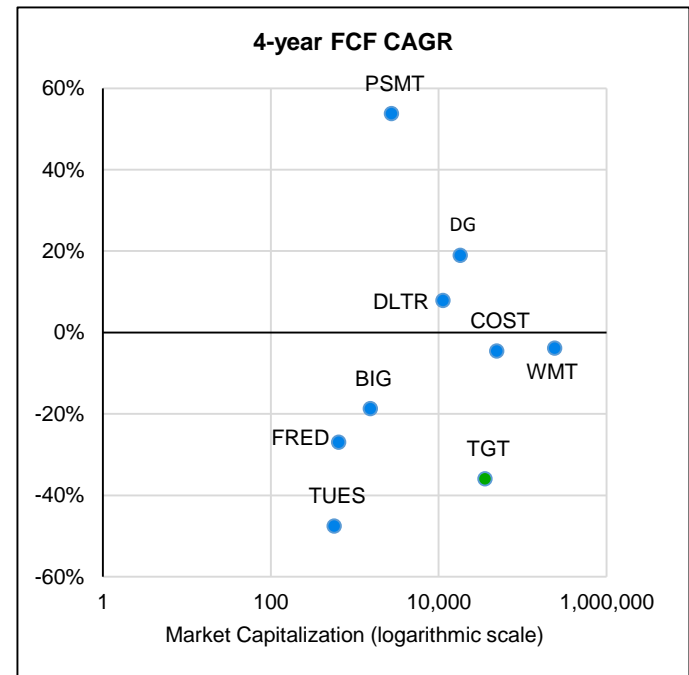


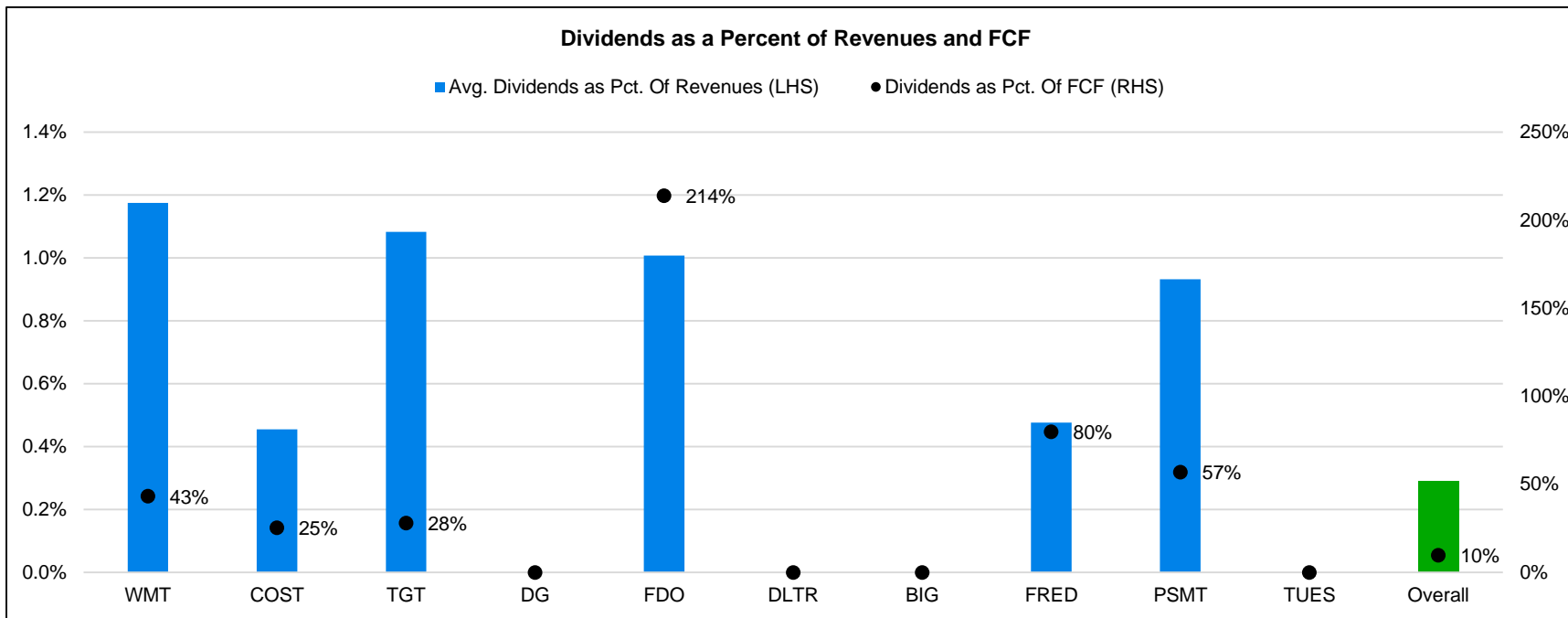
Free Cash Flows have a discretionary component (i.e., managers can choose whether or not to spend money on growth capex) so FCF margins tend to be more variable than OCP.

In FY2011, Target bought the leases of a chain in Canada called Zellers, spending roughly \$1.6 billion. This expenditure ate into the TTM FCF for Target, as did expenditure on new IT systems, according to the 2011 10-K.

The non-Big 3 aggregate dipped in the TTM period ending in April 2013 mainly due to the extreme negative influence of Family Dollar. Family Dollar has been embarking on an aggressive expansion and renovation plan and capital expenditures increased from roughly the \$200 million level in 2010 to the \$700+ million level in 2013.

PriceSmart's revenue growth was outstanding, and its OCP and FCF growth is also at the top of the pack. Even though PSMT is screening as a Value Score 4 stock, seeing these growth statistics makes me want to take a closer look at the company.

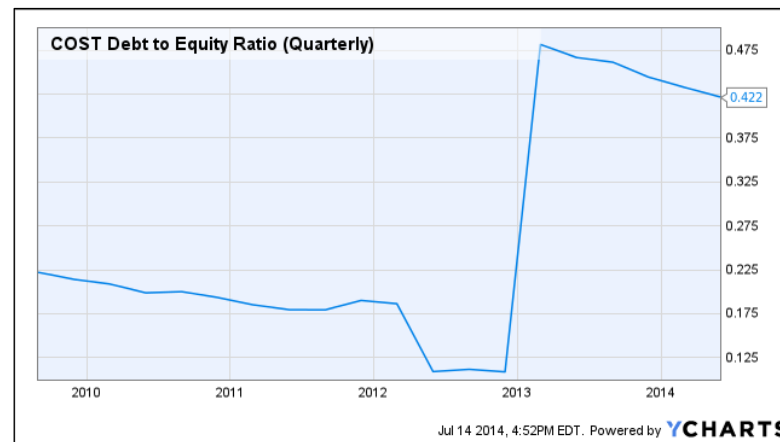


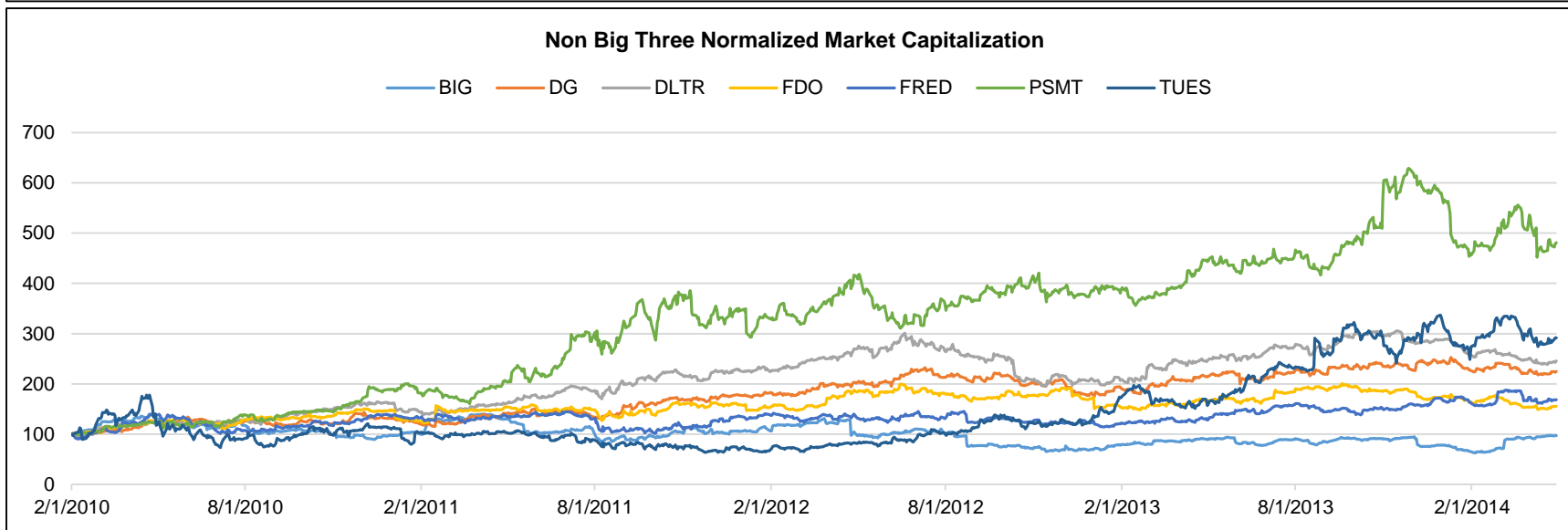
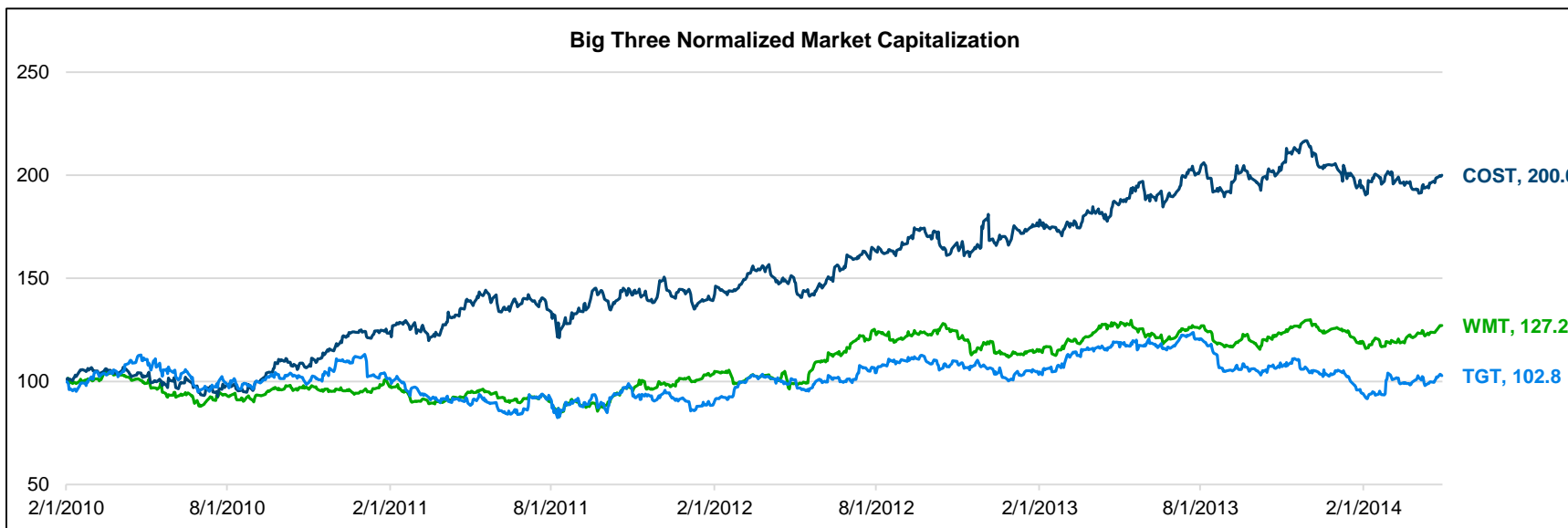


Note that the graph above does not include special dividends of roughly \$3 billion that Costco paid to its shareholders before new laws regarding taxation of dividends went into effect. It is worth noting that Costco paid this special \$3 billion dividend by issuing debt (roughly \$3.5 billion of bonds were issued in all) maturing in 2015, 2017, and 2019 and with an average yield of 1.2%. While the interest rate is low and Costco's balance sheet is strong issuing debt to pay dividends does increase the financial leverage of the company. The chart to the right shows the effect the issuance of this special dividend had on Costco's Debt-to-Equity ratio.

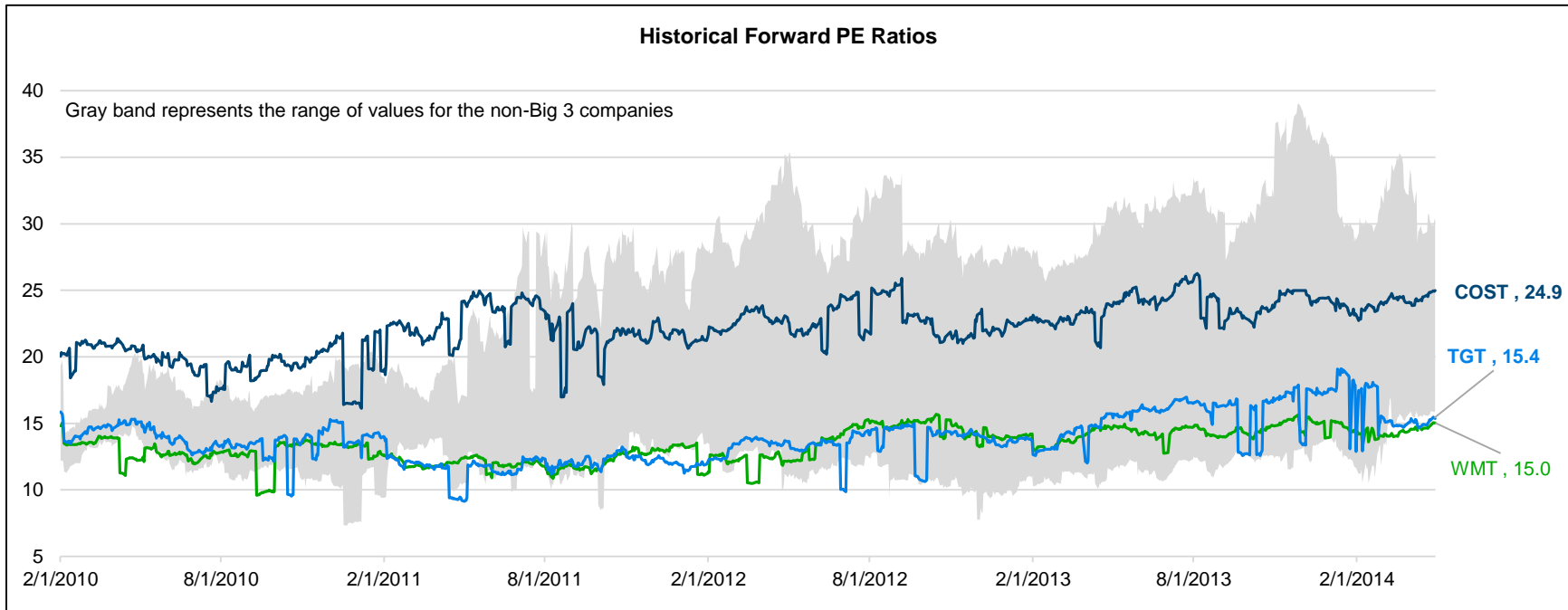
Family Dollar's dividend, is not high from a percentage of revenues perspective, but looks unsustainable vis-à-vis the level of its Free Cash Flows.

Four companies in the group do not pay dividends.





There must be something to the membership warehouse business model. Both Costco and PriceSmart have expanded quickly using this model, much to the delight of their long-term shareholders.



Company	Forward PE	Market Cap (\$ million)	Discount Rate	Implied Earnings Growth
Pricesmart (PSMT)	30.4	2,542	10%	7%
Costco Wholesale (COST)	25.0	51,430	10%	6%
Fred's (FRED)	24.0	554	12%	8%
Family Dollar Stores (FDO)	18.7	7,081	10%	5%
Big Lots (BIG)	16.6	2,483	10%	4%
Dollar Tree Stores (DLTR)	16.6	11,400	10%	4%
Dollar General (DG)	15.9	17,180	10%	4%
Target (TGT)	15.4	38,140	10%	3%
Wal-Mart Stores (WMT)	15.0	270,200	10%	3%

	-2sd	-1sd	Avg	+1sd	+2sd
Wal-Mart (WMT)	10.6	11.6	12.5	13.4	14.3
Costco (COST)	16.8	18.8	20.8	22.8	24.8
Target (TGT)	10.2	11.6	13.0	14.4	15.8

Average Forward PE ratios and their 1- and 2-standard deviation band values are listed above.

As PE ratios climb above the average, a "reversion to the mean" argument would imply selling shares. Conversely, using the same logic, a fall in PE ratios would suggest it is time to buy.

PE Ratios can be thought of as a shorthand way of expressing future growth rates. In the table above, we assume a 12% discount rate for small cap stocks (less than \$1 billion) and a 10% discount rate for medium and large-cap ones, then solve for growth using the Gordon Growth Model equation. Doing so yields the earnings growth implied by the forward PE ratio.

Appendix: Company Descriptions

Company	Market Cap	Value Score	Description
Wal-Mart Stores (WMT)	247,637	8	Wal-Mart Stores Inc, operates retail stores in various formats under various banners. Its operations comprise of three reportable business segments, Walmart U.S., Walmart International and Sam's Club in three categories retail, wholesale and others.
Costco Wholesale (COST)	51,723	5	Costco Wholesale Corp is engaged in the operation of membership warehouses in the United States (U.S.) and Puerto Rico, Canada, the United Kingdom, Mexico, Japan, Australia, and through majority-owned subsidiaries in Taiwan and Korea.
Target (TGT)	38,022	8	Target Corp is engaged in operating general merchandise discount stores in the United States.
Dollar General (DG)	17,225	4	Dollar General Corp is a discount retailer in the United States, which offers a selection of merchandise, including consumables, seasonal, home products and apparel.
Dollar Tree Stores (DLTR)	11,394	4	Dollar Tree Stores, Inc., operates discount variety stores in United States and Canada. Its stores offer merchandise at fixed price of \$1.00 and C\$1.25. The company operates stores under the names of Dollar Tree, Deal\$, Dollar Tree Canada, etc.
Family Dollar Stores (FDO)	7,075	7	Family Dollar Stores Inc operates more than 7,900 general merchandise retail discount stores in 46 states. Its merchandise assortment includes consumables, home products, apparel accessories, seasonal and electronics.
Pricesmart (PSMT)	2,623	4	Pricesmart Inc, through its subsidiaries, is engaged in the ownership and operation of membership shopping warehouse clubs under the trade name PriceSmart in Central America and the Caribbean.
Big Lots (BIG)	2,464	6	Big Lots Inc operates as a broadline closeout retailer in the United States. It offers products under six merchandising categories: Food, Consumables, Soft Home, Hard Home, Furniture & Home Decor, Seasonal, and Electronics & Accessories.
Burlington Stores (BURL)	2,226	None	Burlington Stores Inc is an off-price apparel and home product retailer. It offers ladies sportswear, menswear, coats, and family footwear, as well as baby furniture, accessories, home decor and gifts.
Tuesday Morning (TUES)	731	1	Tuesday Morning Corp is a closeout retailer of upscale decorative home accessories, housewares, seasonal goods and famous-maker gifts in the United States.
Fred's (FRED)	546	7	Fred's Inc, and subsidiaries sells general merchandise through its retail discount stores and full service pharmacies.

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