Family Dollar Stores, Inc. — 2009

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FDO

www.familydollar.com

As the economy limps along in mid-2009 and pushes more households into lower incomes, Family Dollar Store's CEO Howard R. Levine is overseeing continued expansion and growth. His father, Leon Levine, founded the company when he was in his early 20s in 1959, and the elder Levine now sports the title chairman emeritus. Family Dollar offers customers a variety of high-quality, good-value merchandise. The company caters to the low- to low-middle income group (defined as households under $30,000 or $35,000 of annual income) with offerings of competitively priced merchandise in convenient neighborhood stores. Family Dollar Stores has 31 percent of its items priced at a dollar or less.

For 2008, the Dow Jones Average was down 34 percent, the worst year since 1931. Of the S&P 500 stocks index, only 24 stocks were up in 2008. Family Dollar Stores led the way with an increase of 35 percent. Will this solid performance continue?

History

In 1959, when Family Dollar opened its first store in Charlotte, North Carolina, Leon Levine offered customers a varied of good-valued merchandise for under $2. The concept was simple, "The customers are the boss, and you need to keep them happy." Family Dollar went public in 1970, achieved annual sales of $100 million with just under 300 stores by 1977, opened its 1,500th store in 1989 and its 2,500th store in 1996, and grew to nearly 5,000 stores and sales approaching $5 billion when he retired as chairman in 2003. In his high school and college years, his son Howard Levine worked for Family Dollar. Howard was named CEO in 1998, and when his father retired in January 2003, he became chairman and CEO. At age 49, he continues today as chairman and CEO.

Today's Facts and Financials

Family Dollar operates more than 6,600 stores in 44 states plus the District of Columbia. The company does have a small role in international business because about 51 percent of its merchandise is procured from international manufacturers often through agents but also from direct importing from the manufacturers. No single supplier accounts for more than 8 percent of the merchandise purchases. Family Dollar Stores is ranked number 359 on the *Fortune* 500.

Family Dollar continues its strategy of geographic expansion and new store openings. Headquartered near Charlotte, North Carolina, Family Dollar employs 44,000 people, about 25,000 full time and the others as part-timers. Family Dollar's revenues of $6.984 billion in FY2008—the 12 months ended August 2008—showed an increase of 2.2 percent over the year ending August 2007. As indicated in Exhibit 1, the operating profits during FY2008 were $365 million, a decrease of 6 percent from FY2007. The net profit in FY2008 was $233 million, a 4 percent decrease from FY2007.

Divisions of the Company

For FY2008, Family Dollar Stores broke revenues into four broad product categories: consumables, home products, apparel and accessories, and seasonal and electronics. Making comparisons from FY2007 to FY2008, three of the broad product categories had increased sales, but apparel and accessories decreased. Consumables increased by 6.1 percent and represent 61.1 percent of FY2008's total revenues of $6.984 billion. Home products increased by 3.2 percent and make up 14.3 percent of revenues. Apparel and accessories decreased by 6.9 percent and make up 13.1 percent of revenues. Seasonal and electronics increased by 0.8 percent and make up 11.5 percent of revenues. Exhibits 1 and 2 reveal Family Dollar's recent balance sheets.

Since May 1998, the company has provided quarterly cash dividends to its shareholders. The amount per share of these dividends has increased each year (from 4.5 cents per share on July 15, 1998, to 13.5 cents per share on July 15, 2009). This latest dividend yield is about a 1.7 percent return per year, well ahead of the industry average.

Family Dollar continues to seek good locations and contractors to build and maintain stores. The company is involved in real estate management, construction, and store maintenance. Family Dollar has about 15 to 20 percent of its stores up for lease renewal each year. On February 28, 2009, Howard Levine said that the company would definitely try to "leverage the current market to negotiate better rents."

In 2008, Family Dollar opened 205 new stores, closed 64 stores, relocated 17 stores within the same shopping area or market area, and expanded 80 stores. In 2007, the company opened 301 new stores and closed 43 stores.

EXHIBIT 1 Income Statements for Family Dollar

Income Statements for Years Ending August 2008, 2007, 2006
(in millions, except for EPS & Dividends)

	Aug 08	Aug 07	Aug 06
Revenue	**$6,983.6**	**6,834.3**	**6,394.8**
Cost of Goods Sold	4,637.8	4,512.2	4,276.5
Gross Profit	2,345.8	2,322.1	2,118.3
Gross Profit Margin	33.6%	34.0%	33.1%
SG&A Expense	1,980.5	1,933.4	1,756.0
Depreciation & Amortization	149.6	144.1	134.6
Operating Income	376.3	399.3	324.2
Operating Margin	5.4%	5.8%	5.1%
Nonoperating Income	0.0	0.0	0.0
Nonoperating Expenses	(3.5)	–	–
Income Before Taxes	361.8	381.9	311.1
Income Taxes	128.7	139.0	116.0
Net Income After Taxes	233.1	242.9	195.1
Continuing Operations	233.1	242.9	195.1
Discontinued Operations	–	–	–
Total Operations	233.1	242.9	195.1
Total Net Income	**$ 233.1**	**242.9**	**195.1**
Net Profit Margin	3.3%	3.6%	3.1%
Diluted EPS from Total Net Income ($)	1.66	1.62	1.26
Dividends per Share	0.49	0.45	0.41

Source: www.familydollar.com

EXHIBIT 2 Family Dollar's Balance Sheets for Years Ending August 2008, 2007, 2006 (in millions)

Assets	Aug 08	Aug 07	Aug 06
Current Assets			
Cash	$ 158.5	87.2	79.7
Net Receivables	7.0	44.4	2.4
Inventories	1,032.7	1,065.9	1,037.9
Other Current Assets	145.9	339.8	298.9
Total Current Assets	1,344.1	1,537.3	1,418.8
Net Fixed Assets	1,071.9	1,060.7	1,077.6
Other Noncurrent Assets	245.8	26.2	26.6
Total Assets	**2,661.8**	**2,624.2**	**2,523.0**

Liabilities and Shareholders' Equity	Aug 08	Aug 07	Aug 06
Current Liabilities			
Accounts Payable	$ 570.7	644.1	556.5
Short-Term Debt	–	–	–
Other Current Liabilities	498.3	486.2	429.6
Total Current Liabilities	1,069.0	1,130.3	986.1
Long-Term Debt	250.0	250.0	250.0
Other Noncurrent Liabilities	88.7	69.2	78.5
Total Liabilities	1,407.7	1,449.5	1,314.6
Shareholders' Equity			
Preferred Stock Equity	–	0.0	0.0
Common Stock Equity	1,254.1	1,174.6	1,208.4
Total Equity	**1,254.1**	**1,174.6**	**1,208.4**
Shares Outstanding (mil.)	140.2	140.2	140.2

Source: www.familydollar.com

Competition and Industry

The small-box discount retailers industry reported strong performance in the last half of 2008 and the first half of 2009.

The three largest small-box discount retailers are Dollar General, Family Dollar, and Dollar Tree. These three dollar stores realize that they are different from the giant Wal-Mart in many ways, including offering lower prices.

All three of these small-box companies have to deal with many rivals, including Fred's, 99 Cents Only, Wal-Mart, Big Lots, CVS, J.C. Penney, Kmart, Meijer, Sears, Target, Walgreen, Costco, Kroger, and many other small regional chains and one-of-a-kind retailers. Exhibit 3 compares the three largest small-box discount retailers.

Dollar General

Headquartered in Tennessee, Dollar General's stores are typically located in small towns, but big-city stores (usually situated in lower-income neighborhoods) account for 30 percent of its total. About 35 percent of its products are priced at $1 or less. Dollar General was taken private by affiliates of KKR and Goldman Sachs in 2007.

Dollar Tree

Headquartered in Virginia, Dollar Tree stresses the $1 price points and offers a range of merchandise including housewares, seasonal goods, food, toys, personal accessories, health

EXHIBIT 3 The Three Largest Small-Box Discount Retailers

	Dollar General	Family Dollar	Dollar Tree
2008 Annual Sales	$9,454 Million	$6,984 Million	$4,645 Million
Sales Growth	2.9%	2.2%	9.5%
2008 Net Income	($13 Million)	$233 Million	$230 Million
Long-Term Debt	$4,130 Million	$250 Million	$268 Million
# of Stores	8,400	6,600	3,600
Store Size (sq ft)	7,000	7,500 to 9,000	5,000 to 10,000
# of States	35	44	48
# of Employees	71,500	44,000	46,000
# of Distribution Centers	9	9	9
Year Started	1939	1959	1953
Fortune 500 Rank	359	499	

Source: Company *Form 10K* Reports.

and beauty care products, party goods, greeting cards, and books, mostly for $1 even. Dollar Tree operates stores called Dollar Tree, Dollar Bill, Dollar Express, Only 1.00, and Only One. About 40 percent of the company's merchandise is imported, mostly from China. Dollar Tree does offer online sales. Dollar Tree Inc. recently sneaked into the latest *Fortune* 500, now at number 499.

Mission

Family Dollar's mission statement is provided in Exhibit 4.

Operations

Even compared to Wal-Mart, Family Dollar is considered to be a leader in keeping costs low. The company continues to review and improve each step in the supply chain, from vendor selection to stocking store shelves. Family Dollar has undertaken initiatives to improve supply chain effectiveness.

Nearly all Family Dollar stores range in size from 7,500 to 9,000 square feet and are operated in leased facilities. The company pursues this strategy of relatively small stores as a way to open new stores in rural areas, small towns, and large urban neighborhoods. Whenever feasible, Family Dollar likes to have a parking lot located immediately near the store's entrance, and nearly all stores have only one entrance. The size of the stores (about 1/22 the square footage of a typical Wal-Mart Supercenter) has appeal to customers who like the convenience and short walk, which cannot be matched by some of the large store chains.

Over the past few years, Family Dollar has improved its logistics network and is moving toward a world-class distribution system. CEO Howard Levine said. "It's a Wal-Mart formula. We have to deliver goods efficiently to the stores, and we've been able to do that."

EXHIBIT 4 Mission Statement and CEO's Comment

Family Dollar's mission states the three most important relationships critical to making our business successful: our customers, our associates, and our investors.

For our customers, we offer a compelling place to shop by providing convenience and low prices;

For our associates, we offer a compelling place to work by providing exceptional opportunities and rewards for achievement;

For our investors, we offer a compelling place to invest by providing outstanding returns.

To support its retail operations, Family Dollar operates nine automated full-service distribution centers (each ranging in size from 850,000 square feet to 907,000 square feet) that ship directly to company stores. The company uses a Web-based transportation management system, voice-recognition software, radio-frequency technology and high-speed sorting systems for better distribution process efficiency. Family Dollar has a strong presence in the southern United States. Seven of its nine distribution centers are located in the South (northern Virginia, western North Carolina, panhandle of Florida, eastern Kentucky, eastern Arkansas, southwestern Oklahoma, and western Texas); the other two are in upstate New York and eastern Iowa. The company operates few stores in the Rocky Mountain region and only the Nevada stores in the Pacific time zone. Exhibit 5 shows the store locations.

EXHIBIT 5 Family Dollar, by State and Number of Stores

Number of Stores per 100,000 population	
# of Stores	# of Stores per 100,000 Population
NORTHEAST	
Maine 46	3.49
New Hampshire 22	1.67
Vermont 12	1.93
Massachusetts 99	1.53
Rhode Island 20	1.90
Connecticut 51	1.46
New York 290	1.49
Pennsylvania 264	2.11
New Jersey 80	0.92
Delaware 21	2.41
Maryland 92	1.64
District of Columbia 3	0.50
SOUTH	
Virginia 214	2.75
West Virginia 115	6.34
North Carolina 364	3.95
South Carolina 198	4.42
Georgia 303	3.07
Florida 363	1.98
Kentucky 186	4.36
Tennessee 204	3.28
Alabama 145	3.13
Mississippi 118	4.02
Arkansas 98	3.43
Louisiana 229	5.19
MIDWEST	
Ohio 411	3.58
Indiana 195	3.04
Michigan 348	3.48
Wisconsin 140	2.49
Illinois 238	1.84

continued

EXHIBIT 5 Family Dollar, by State and Number of Stores—continued

# of Stores	# of Stores per 100,000 Population
Minnesota 71	1.36
Iowa 32	1.07
Missouri 96	1.62
North Dakota 11	1.71
South Dakota 22	2.73
Nebraska 31	1.74
Kansas 35	1.25
SOUTHWEST & MOUNTAIN	
Oklahoma 128	3.51
Texas 817	3.36
Wyoming 20	3.75
Colorado 104	2.14
New Mexico 90	4.54
Arizona 130	2.00
Utah 60	2.19
Idaho 31	2.03
Nevada 24	0.92

Aggregate Information

44 + DC 6,572 2.61 one store per 38,380 population

There are no stores in Montana, Washington, Oregon, California, Alaska, and Hawaii.

Source: Family Dollar Stores, *Annual Report* (2008); www.infoplease.com/ipa/A004986.html.

Family Dollar's transportation technologies include a Web-based Transportation Management System (TMS) that allows vendors to release purchase orders electronically. Family Dollar Trucking, Inc. (FDTI) provides a private fleet of trucks that have received safety rewards. More recently, Family Dollar is beginning to use some of these same systems in international transportation.

Family Dollar is now using POS (point of service) systems that provide access to both centralized and decentralized store applications, enabling higher employee productivity, improved customer service, and some new revenue streams. Family Dollar is working with Toshiba TEC American on this. According to Howard Levine, the company is "accelerating the completion of the POS rollout by January or February of 2010, which we're well on track of doing." In these endeavors, Family Dollar continues to partner with Toshiba TEC America and Microsoft.

Family Dollar recently hired Sylvania Lighting Services (SLS) to install new lighting to save energy, reduce maintenance, drive down operation costs, and improve store light (brightness) levels in all its stores. "The new lighting program is a huge win for Family Dollar, which yields a reduction in overall lighting maintenance costs, budget future lighting expenses over four years at fixed costs and allows them to achieve tremendous energy savings while integrating environmental sustainability," said Scott Agnew, SLS executive account manager. The lighting upgrades also gave Family Dollar some tax breaks.

Marketing

While other retailers have courted a more upscale clientele by adding designer clothes and fine jewelry, Family Dollar has stayed true to its roots. A typical shopper earns just $35,000 per year. According to Howard Levine, "We want our customers to know they can afford anything in our store."

Beyond the four broad product categories, Family Dollar's merchandise assortment are divided into 11 product classifications that include apparel, food, cleaning and paper products, home decor, beauty and health aids, toys, pet products, automotive products, domestics, seasonal goods, and electronics.

Family Dollar's merchandise includes national brands, Family Dollar private labels, and unbranded items that sell for less than $10. Whereas some other discount retailers focus on factory closeouts, these make up only about 2 percent of Family Dollar's sales. The company carries many name-brand items found in supermarkets, such as Tide, Colgate, and Clorox. Some analysts estimate that Family Dollar's prices are 20 to 40 percent cheaper than those found in traditional supermarkets and are roughly on par with big-box discounters such as Wal-Mart and Target or lower.

Family Dollar emphasizes convenience for its customers. It sees the typical scenario as based on easy-to-shop neighborhood locations that allow "Mom to get what she needs, close to home to take care of her family." In 2008, the company introduced a new logo to facilitate achieving this emphasis. Along with the new logo, Family Dollar has developed a new tag line: "My family. My family dollar." These recent updates assist the company toward conveying its commitment to providing value and convenience with a family focus.

Family Dollar does not make use of Web site sales. The company has lagged behind many other retailers in accepting food stamps and other payment forms. Family Dollar and its dollar-store direct competitors still face an image problem of a perception of an old, cluttered, and dirty store. One customer complained that one week the store might carry Green Giant canned corn and then Libby's the next. From the management of Family Dollar's perspective, this would be termed "opportunistic buying." By late 2009, Family Dollar plans to introduce 250 new edible items, including Triscuits and Double Stuf Oreos as a way to attract more customers. Some would categorize the company's increased emphasis on food and slightly increased plan to put more stores in urban areas as a differentiation strategy.

Human Resources

About 15 percent of Family Dollar's top 41 executives are women. Family Dollars' corporate board of directors has 10 members ranging in age from 47 to 78 (with a mean and median age in the mid-60s), which includes three women but only one insider (Howard R. Levine) with the other nine being nonemployees of the company.

In July 2006, Family Dollar lost a federal court case in Tuscaloosa, Alabama, that amounted to $35.6 million. This decision was upheld on December 16, 2008, by the U.S. 11th Circuit Court. The case involved store managers not being paid for overtime. The class action judgment was on behalf of 1,424 managers. The affected managers were awarded back pay. The managers had argued that Family Dollar owed them overtime wages under the Fair Labor Standards Act (FLSA). Family Dollar's corporate management contended that the managers held executive authority and were thus exempt from the FLSA requirements. Partly because the store managers had no power to hire and fire staff, they reportedly often worked 60 to 70 hours per week doing a variety of nonmanagerial work activities such as operating cash registers and manual labor such as stocking shelves, unloading trucks, and cleaning floors.

Conclusions and the Future

Family Dollar believes it can prosper in a limping U.S. economy and perform even better in a strong economy. But with issues such as litigation, competition, increasing labor costs, and efficiency issues in supply chain management and elsewhere, Family Dollar faces challenges as it continues to grow toward 10,000 stores.

In April 2009 as the economic recession continued, Family Dollar's Public Relations Manager Josh Braverman said, "Thrift is in. Saving money is in. And it still will be even after the economy recovers." Although penny-pinching moms are important to Family Dollar, the future is not a sure thing. Can Family Dollar perform well both in good economic times and in bad economic times? To many business experts, it seems unreasonable to be able to have it both ways.

As indicated in Exhibits 6 and 7, Family Dollar's third-quarter (ending May 30, 2009) results were excellent. Compared to one year earlier (May 31, 2008), net sales

EXHIBIT 6 Family Dollar's Consolidated Statements of Income (unaudited)

(in thousands, except except per share amounts)	For the Third Quarter Ended			
	May 30, 2009	% of Net Sales	May 31, 2008	% of Net Sales
Net sales	$1,843,089	100.0%	$1,702,197	100.0%
Cost of sales	1,175,897	63.8%	1,112,755	65.4%
Gross profit	667,192	36.2%	589,442	34.6%
Selling, general and administrative expenses	528,158	28.7%	487,835	28.7%
Operating profit	139,034	7.5%	101,607	5.9%
Interest income	879	0.0%	2,973	0.2%
Interest expense	3,216	0.2%	3,361	0.2%
Income before income taxes	136,697	7.3%	101,219	5.9%
Income taxes	48,976	2.7%	36,546	2.1%
Net income	$ 87,721	4.6%	$ 64,673	3.8%

Source: Family Dollar Stores, Inc.

increased by 8.3 percent, net income increased by 35.6 percent, net income per common share increased from 46 cents to 63 cents. Net sales increased by 12.6 percent for consumables, dropped by 5.0 percent for apparel and accessories, rose by 3.5 percent for home products, and increased by 5.8 percent for seasonal and electronics. The number of "stores in operation" was 6,654 on May 30, 2009, up from 6,545 on May 31, 2008. Sales in comparable stores reported to increase by 6.2 percent. During the quarter, Family Dollar repurchased approximately 1.2 million shares of its common stock at a total cost of $38.5 million. Exhibit 8 reveals the company's recent store opening/closing activity.

EXHIBIT 7 Family Dollar Stores, Inc., and Subsidiaries Selected Additional Information

Net Sales by Category

(in thousands)	For the Third Quarter Ended		
	May 30, 2009	May 31, 2008	% Change
Consumables	$1,201,033	$1,066,649	12.6%
Home products	237,384	229,528	3.4%
Apparel and accessories	219,193	230,784	–5.0%
Seasonal and electronics	185,479	175,236	5.8%
TOTAL	$1,843,089	$1,702,197	8.3%

(in thousands)	For the Three Quarters Ended		
	May 30, 2009	May 31, 2008	% Change
Consumables	$3,565,542	$3,139,544	13.6%
Home products	771,577	774,518	–0.4%
Apparel and accessories	620,175	686,341	–9.6%
Seasonal and electronics	631,888	617,448	2.3%
TOTAL	$5,589,182	$5,217,851	7.1%

Source: Family Dollar Stores, Inc.

EXHIBIT 8 Family Dollar's Stores in Operation

Stores in Operation	For the Three Quarters Ended May 30, 2009	May 31, 2008
Beginning Store Count	6,571	6,430
New Store Openings	148	165
Store Closings	(65)	(50)
Ending Store Count	6,654	6,545
Total Square Footage (000s)	56,527	55,575
Total Selling Square Footage (000s)	47,060	46,194

Source: Family Dollar Stores, Inc.

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