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BY JAY NEWTON-SMALL

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**Million Dollar
Brands!**



The Buck Shops Here

Dollar stores won Walmart customers during the recession—and plan to keep them

BY SEAN GREGORY/CHARLOTTE

THE BATTLEFIELD FOR THE MIND and wallet of the American consumer is splayed across a strip mall in Charlotte, N.C. On one side of the parking lot, nestled between an empty storefront and the Family Christian store, is a Dollar Tree. At Dollar Tree, a chain of 4,000 superdiscount outlets, every item indeed costs a dollar or less. If anyone needs a reminder, the signage on top of the store and three stickers on the front window scream, "Everything's a Dollar! Everything's a Dollar! Everything's a Dollar!"

This Dollar Tree faces a sprawling Walmart Supercenter—a runt ready to take swings at a schoolyard bully. And it's connecting. Hard. Sales at Dollar Tree and other outlets in the rock-bottom sector of retailing are booming, the companies earning record profits. Meanwhile, at Walmart, U.S. same-store sales have declined for six straight quarters. Walmart is instead seeking growth in Africa, where it plans to purchase control of Massmart, a sub-Saharan discount retailer.

This fascinating contrast can be explained in part by Bridget Frankel, a mother of five, who says the economy is always on her mind. Her husband has been forced to switch jobs four times since the family moved to North Carolina from Ohio five years ago. A 10.4% unemployment rate is dogging the Charlotte area, so she's not confident about her family's prospects. That's why Frankel makes more trips to Dollar Tree, where she snaps up school supplies and holiday decorations and other stuff she used to buy at Walmart. At Dollar Tree, she'll sometimes give her kids \$5 and send them on a treasure hunt. They usually pick up toys, but her daughter once returned with some kind of lighted toenail clipper. "Hey, if it's something ridiculous," she says, "it's only a dollar."

The darkest days of the Great Recession hammered retailing. Same store sales for upscale merchants like Saks and Aber-

crombie & Fitch fell by comical numbers, more than 25%. Circuit City and Linens 'n Things got wiped out. There are shuttered stores everywhere, emptying jobs along with their shelves.

Out of the economic collapse came what consumer analysts called the new normal or the great reset: after years of borrowing to spend beyond their means, Americans were going to change their habits. Cheap was the new chic. Or is it? Retail sales are up 11.2% from the lows of the recession and off just 1.8% from precession peaks. After a disastrous 3.9% downward spiral in 2008 and a less than stellar 0.4% uptick in 2009, sales are forecast by the National Retail Federation to increase 2.3% this holiday season compared with last year's.

Americans are spending again, but not uniformly. Luxury buying has rebounded, but shoppers are also channeling more of their money into the dollar stores. "We didn't expect to be promoting the stocks of the discounters at this stage of the recovery," says Laura Champagne, a retail analyst at Cowen & Co. "This reflects the high unemployment levels and a value-

focused consumer. Usually, we'd be recommending the growth-oriented retailers, not the bottom feeders."

From Second-Rate to Record Sales

WALK INTO THAT DOLLAR TREE IN CHARLOTTE and you'll find the usual collection of made-in-China clutter: whoopee cushion over there, a garish plastic headband over here. But Dollar Tree and its deep-discounting cousins Dollar General and Family Dollar, which offer about 25% to 30% of their merchandise for a buck and keep the bulk of it under \$10, are no longer pushing just garage-sale junk. At Dollar General, for example, about 70% of the products are consumables like dry goods, drinks, paper towels, toothpaste and diapers.

This is stuff people need, priced attractively to draw traffic to the stores. Eight years ago, about 60% of Dollar General's product assortment consisted of consumables. And now about 78% of those products are national brands: Tide, Bounty, Crest, Coca-Cola, Cheerios. "National brands give us legitimacy with our trade-down customer," says Mary Winn Gordon, vice president for investor and public relations at Dollar General, a \$12 billion company based near Nashville with 9,273 stores in 35 states. "And our core consumer is aspirational and wants to see those brands." Yet Dollar General's fastest-growing customer segment is households making more than \$70,000.

Dollar General has also been a bright spot for private equity firm KKR, which bought the company in a 2007 leveraged buyout for \$7.3 billion. A number of private equity firms have gotten burned by such buyouts in the past three years, but KKR installed a new management team at Dollar General that took a more scientific approach to analyzing neighborhood demographics so it could optimize new locations. Dollar General also took advantage of the soft real estate

NO DISCOUNT HERE

Shares of the dollar stores are rocketing, while Walmart shares and the S&P 500 lag



market to open 250 new stores in 2008, 500 in 2009 and 600 this year. And all its stores are selling more merchandise. At the end of 2007, Dollar General sold \$165 per sq. ft. (0.09 sq. ft.) of real estate. By end of the second quarter of this year, sales jumped to \$199 per sq. ft., a 21% increase. The company went public again in November 2009. The stock is up some 50% since the offering.

Over the past few years, all the dollar stores have become more competitive:



Cheap but rich Seasonal items like Santa hats drive healthy profits for dollar stores

they're brighter, more organized and easier to navigate. Dollar General and Family Dollar, for example, have raised signage in newly renovated stores so shoppers can map out their trip with a quick upward glance. They need that kind of guidance, as these low-cost chains can't afford many customer-service reps. The stores have also become less scattershot and more strategic in how they're laid out, moving high-traffic items like paper towels to the back, for instance, to force shoppers to peruse the higher-margin seasonal stuff too.

These moves are helping dollar stores mint record profits. In early December, Dollar General announced a 68% rise in quarterly profits over the previous year; Family Dollar earned \$358 million for the fiscal year that ended in August, a 23% rise. From February 2010 to the end of October, Dollar Tree netted \$234.8 million, a 149% increase over the same period four years ago.

How can stuff that sells for a buck or two earn so much? Just set up shop in lower-rent areas, source some stuff to China and other cheap places, and keep the store size manageable. Dollar Tree

stores are 8,580 sq. ft. (797 sq m) on average; Walmart discount stores average 108,000 sq. ft. (10,033 sq m), while the Supercenters are some 185,000 sq. ft. (17,187 sq m). The small-box stores offer a narrower selection of items, holding inventory costs down. The key is item velocity. "We can make good money on an item we sell for a dollar," says Howard Levine, the CEO of Family Dollar, from his office near Charlotte. Potential locations for new distribution centers are tacked on a

The message seems to be getting through. According to Dollar General's research, for example, 95% of new and existing customers say they'll keep shopping at the store after the economy improves. "We know customers are only saying this," says Winn Gordon. "But cut it by whatever percentage you want to, it's still a pretty darn good number."

The dollar stores are nervous, though, because the world's largest retailer hovers over them. "Walmart always worries me," says Levine, the Family Dollar CEO. "You can't out-Walmart Walmart. The dollar stores are not going after the same trip Walmart is going after. We're going after the fill-in trip. We live off the crumbs they leave us." Walmart is not going to allow itself to be underpriced on critical items like diapers. In Charlotte, for example, a pack of 42 size-2 Huggies diapers retailed for \$10 at both Dollar General and Family Dollar and \$8.97 at a nearby Walmart. Sometimes Walmart even beats Dollar Tree, the buck-only store, at its own game.

The dollar stores can live with those battles, but the retail giant may be preparing to move directly onto their turf by building small stores. Walmart is scouting locations for urban stores—smallmarts—which could steal some fill-in traffic from places like Dollar General and Family Dollar. "Walmart is not a dodo bird," says Richard Hastings, a strategist at Global Hunter Securities. "If you start to wake them up, boy, they're going to start pecking away at you."

That's why the dollar stores are working to build loyalty and capitalizing on shifts in consumer thinking. In Charlotte one evening, Lisa Abrams-Coltrane, whose work hours at Hardee's had been cut over the past year, was making one of her frequent trips to Dollar Tree. Though Dollar Tree doesn't offer as many consumable items or national brands as its competitors, Abrams-Coltrane was grabbing things off the shelves as if they were apples off a tree, hurrying to make her bus. Hamburger buns, a package of french fries, Palmolive dish soap and Vlasic pickles are all in her cart. She paid \$10 for 10 items and bounced out of the store. "Now you see everyone and their mother in here," Abrams-Coltrane says. "Everybody is trying to get a deal."

Some of her friends still won't set foot in a dollar store. A few years ago, she might have felt the same way. Now? "I'm like, Why are you so afraid?" she says. "You find it demeaning? I don't understand that. At this point, there are like 4,000 of these stores around here. Someone's shopping at them. And it's not all poor people."

map on his wall. "You just don't make a lot of it unless you sell a lot of it. We have 6,800 stores. If you sell one item a week in 6,800 stores, no matter what the price point, you've got a lot of velocity there."

More than the Poor

CAN ANYTHING SLOW THESE STORES down? Dollar stores face the occasional public relations mishap that comes with selling lesser goods. The asphyxiation deaths of two boys prompted a government recall in May of a toy dart gun sold at Family Dollar. At Dollar Tree, I picked up a \$1 plastic football for my 2-year-old son. After he carried it around for a couple of days, an air bubble emerged, like some kind of abscess. Afraid it might explode in his face, I tossed it into the trash.

The more pressing challenge facing these stores, however, is to keep shoppers from trading back up to higher-priced outlets as the economy rebounds. Despite their improvements, dollar stores can still carry a stigma. "We have to disrupt the perception that we don't have quality, we don't have national brands," says Don Hamblen, senior vice president for consumer marketing at Family Dollar.