

Family Dollar Acquisition

September 7, 2014



Duke Investment Club

Introduction

So you want to work at an Investment Bank...

- Investment Banks provide many different services
- Main focus for Duke students: Investment Banking, Sales & Trading, Research
- We'll look at how each division would touch the Family Dollar acquisition



Session Agenda

- I. M&A Overview
- II. Business Overview
- III. Acquisition Timeline
- IV. Investment Banking
- V. Sales & Trading
- VI. Research
- VII. Predictions

What are Mergers & Acquisitions?

- **M&A:** Buying, selling, dividing, and combining of different companies
 - Often a path to growth
 - Deals are inherently complex and laden with risk
- Sell-Side M&A Deals
- Buy-Side M&A Deals
- “Friendly Transaction” vs “Hostile Takeover”



Merger

- Two firms agree to go forward as a single new company rather than remain separately owned and operated
 - Often among two similarly-sized firms
- **Consolidation:** An entirely new company is formed

Acquisition

- Generic term used to describe a transfer of ownership from one company to another
 - “Target” company sometimes ceases to exist
 - “Buyer’s” stock continues to be traded
- An acquisition may occur without a merger
 - Buyer simply purchases the stock or assets of target (possibly a majority share)
 - Acquired company remains a separate entity

Successful M&A Deals

Mergers

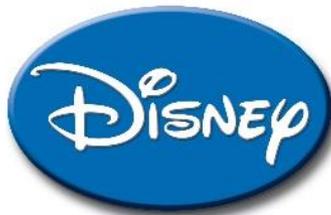
1998



2006



2007



Acquisitions

2009



2012



2014



Microsoft



NOKIA

Breakdown

Questions to Consider

- Synergies:
 - Does combining our companies make strategic sense?
 - What can we do together that we could not do separately?
- How much should we pay (or be paid)?
- Which company should be the buyer, and which the seller (in an acquisition involving two companies of similar size and market value)?
- What kind of financing can be obtained?
 - How much control will a financing third party want?
 - How will this transaction affect our balance sheet?

Advantages

- Better management and technical skills
- Economies of scale and scope that can reduce cost, improve quality, and increase output
- Diversification of company's products
- Increase spending for R&D

Disadvantages

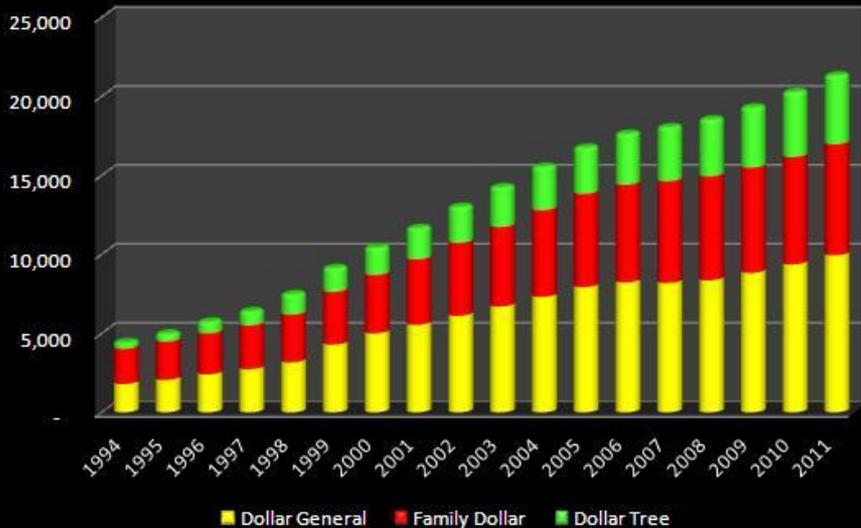
- Reduction in competition in the industry leading to higher prices
- Less choice for the consumer
- Diseconomies of scale can result if the new firm is too large to manage
- Job loss

Business Overview

Rise of the Dollar Store Industry

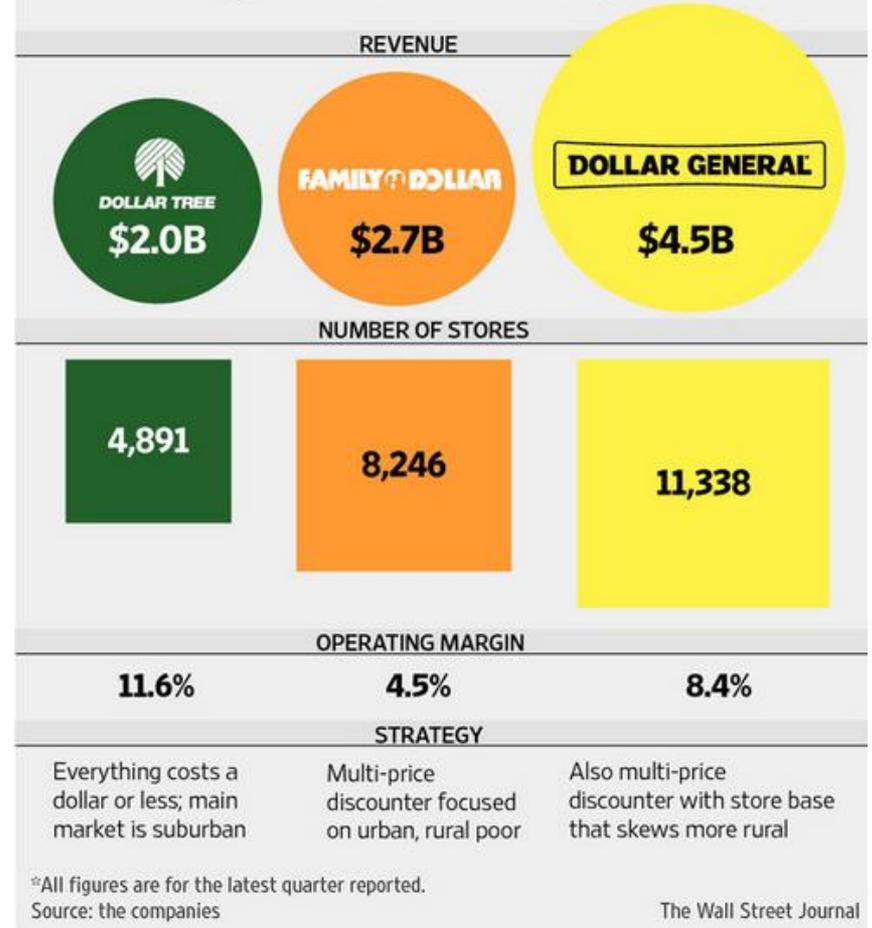
- \$56 billion industry
- 43% increase from 1998
- More dollar stores than drug stores nationwide

The Rise of the Dollar Store Dynasty



Dollar Giants

How the three biggest U.S. dollar-retail chains compare*



The Wall Street Journal

Acquisition Timeline

Starting in 2011, Family Dollar has been the target of buyouts and activist investors. However, the buyout talks heated up in June 2014, leading to two competing bids.

2011: Nelson Peltz, activist investor of Trian Fund Management, bids unsuccessfully for Family Dollar. Even though he does not own it, he remains a large shareholder.

June 6, 2014: Carl Icahn, activist investor, discloses a 9.39% stake, with an average price of \$58.60/share in Family Dollar and hopes to “discuss strategic alternatives”.

June 19, 2014: Icahn urges the Family Dollar Board of Directors to put itself for sale immediately or else he will ask shareholders directly to throw out the Board.

July 28, 2014: Dollar Tree bids \$8.5 billion (\$74.50/share) for Family Dollar.

August 18, 2014: Dollar General counters with a \$8.9 billion (\$78.50/share) offer. Deal rejected.

September 2, 2014: Dollar General increases its bid up to \$9.1 billion (\$80/share) and warns of hostile action if offer is rejected.

September 4, 2014: Carl Icahn sells his stake in Family Dollar making a \$200 million profit.

September 5, 2014: Family Dollar rejects Dollar General’s newest offer.

2011

June 2014

July-August 2014

September 2014

Deal Breakdown

Dollar Tree's Offer

- \$74.50/share → \$8.5B
- \$59.60 cash + \$14.90 in Dollar Tree stocks
- Levine, son of the founder of Family Dollar, would remain onboard
- Willing to divest unlimited stores*

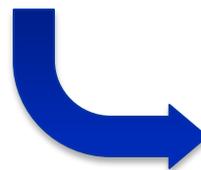


DOLLAR TREE



Dollar General's Initial Offer

- \$78.50/share → \$8.9B
- All cash
- Divest 700 stores
- Family Dollar rejected the offer citing it won't be approved by regulators



Dollar General's Second Offer

- \$80/ share → \$9.1B
- All cash
- Divest 1500 stores
- Will pay \$305M breakup fee & \$500M if deal is rejected by FTC
- Rejected by Family Dollar citing antitrust laws

Investment Bank's Role in Family Dollar Acquisition

■ Coverage Group (Often referred to as the Industry Group)

- Specialize in a certain industry but work on a variety of deals
- Maintain relationships with large companies
 - In the Family Dollar acquisition the coverage group would be the division who would most likely have pitched the idea to the company.

■ Product Group

- Specializes in a certain type of financial product or a certain type of deal
- Areas of interest include (Debt, Restructuring, M&A, IPO's, etc.)
 - In the case with Family Dollar since this is a M&A deal, the M&A product group would help with creating a number of "Merger Models" or "Acquisition Models" in this type of deal
 - They also help in the bidding process to determine what is a good deal in the long run

Banks Advising Dollar Tree, Dollar General, and Family Dollar



J.P.Morgan



Morgan Stanley

Sales & Trading

Sales

- Develop relationship with clients (classic & institutional)
- Sell stocks and stock advice
- Make money through the commission they make on their trades

Traders

- Facilitate the buying and selling of stocks, bonds, and other securities such as currencies
- Provide liquidity to the market
- “Market makers”
- Make money through “bid-ask spread”



Research

What do they do?

- Write research reports
- Analyze public companies/debt
- Equity vs. Credit Research
- Research associate, junior/senior research analyst
- Communicate with external clients (investors)
- Personal reputation very important

How is Research involved in Acquisition?

- Does almost nothing to contribute to the merger

PiperJaffray

COMPANY NOTE
July 29, 2014

Family Dollar Stores, Inc. (FDO)

Neutral

Premium Takeout Multiple Offered But Deal Likely to Close; Upgrading to Neutral

CONCLUSION

We are upgrading shares of FDO to Neutral following DLTR's offer to buy FDO for \$74.50 per share consisting of both cash and DLTR stock. Based on the takeout multiple of 11.3x TTM EBITDA and 22.6x our forward 12-month EPS estimate, FDO shareholders are being handsomely compensated for their shares given the business was in transition and under significant pressure. All-in we still remain surprised by yesterday's announcement as we didn't previously feel that DLTR was the logical acquirer for FDO. We anticipate that this deal will get FTC clearance and close in early 2015 as scheduled, and thus no longer recommend under-weighting the stock. We are raising our price target to \$74.50 -- in line with the buyout price.

Transaction Details. The total enterprise value of the FDO buyout is ~\$9.2B and DLTR is paying the equivalent of 11.3x trailing 12-month EBITDA (quarter ended May 2014). FDO shareholders will receive the equivalent of \$74.50 for each share which will be made up of \$39.60 in cash and \$14.90 in stock. The stock portion of the buyout is subject to a collar with FDO holders receiving 0.2484 DLTR shares if the average DLTR trading price is equal to or greater than \$39.98, 0.3036 DLTR shares if the average DLTR trading price is less than or equal to \$49.08 and if the average DLTR trading price is between \$49.08 and \$39.98 FDO shareholders will receive a number of shares between 0.2484 and 0.3036 equal to \$14.90 in value. Our 12-month forward EPS estimate of \$3.29 implies a 22.6x multiple paid for FDO shares. The deal is expected to close in early 2015 and has a \$800M termination fee.

Concerned about Lower Income Consumers. As we highlighted in our May 29 industry note, headwinds on the lower income consumer segment remain steady. The reduction in SNAP (food stamp) benefits continues to appear to be the most impactful at this point and we expect this reduction to be a headwind through the remainder of the year. Looking ahead to 2015, the Affordable Healthcare Act could be a headwind as only ~10M signed up for a healthcare plan out of the ~45M uninsured individuals in the US. Additional sign-ups over the coming year could take additional income away from lower income households.

FDO Unlikely to Get Another Higher Bid. Given the premium takeout multiple FDO is receiving, and the ongoing headwinds on lower income consumers, we believe it is unlikely FDO will receive a higher bid from a financial buyer. In looking at another strategic buyer, DG is the candidate that makes the most sense but given its current CEO transition we believe DG is unlikely to get involved.

RISKS TO ACHIEVEMENT OF PRICE TARGET

Risk factors include macroeconomic factors and variables, weather conditions, changes in the retail calendar and potential for disruptions due to store remodels.

COMPANY DESCRIPTION

FDO is a leading discount retailer operating more than 8,000 stores in 45 states offering quality, low-cost merchandise in a convenient setting.

YEAR	REVENUE (US\$ m)										EARNINGS PER SHARE (US\$)					
	Nov	Feb	May	Aug	FY	CY	FY RM	CY RM	Nov	Feb	May	Aug	FY	CY	FY P/E	CY P/E
2013A	2,471.7	2,594.0	2,773.5	2,900.3	10,391.5	10,469.1	0.8x	0.8x	0.69	1.21	1.05	0.86	3.80	3.80	19.9x	19.9x
2014E	2,499.2A	2,716.6A	2,999.0	3,148.9	10,424.2	10,485.5	0.8x	0.8x	0.68A	0.99A	0.75	1.07	3.75	3.75	24.7x	24.0x
2015E	2,562.0	2,979.9	2,711.5	2,896.9	10,464.3	—	0.8x	NA	0.75	0.82	0.97	0.80	3.33	—	22.2x	NA

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Family Dollar Stores, Inc.

Page 1 of 9

PRICE: US\$75.74
TARGET: US\$74.50

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Changes	Previous	Current
Rating	Underweight	Neutral
Price tgt	US\$50.00	US\$74.50
FY14 Rev (mil)	—	US\$10,424.2
FY15 Rev (mil)	—	US\$10,464.3
FY14 EPS	—	US\$3.07
FY15 EPS	—	US\$3.33
52-Week High / Low	US\$76.82 / US\$55.64	
Shares Out (mil)		114.1
Market Cap. (mil)		US\$8,544.9
Avg Daily Vol (100s)		1.647
Book Value/Share		US\$4.91
Net Cash Per Share		US\$4.91
Debt to Total Capital		32%
Div (ann)		US\$1.24
Yield		1.64%
Fiscal Year End		Aug

Price Performance - 1 Year



Predictions

Acquisition by Dollar Tree

- Antitrust laws
- Hostile takeover cost
- Levine's, CEO of Family Dollar, incentive to accept
- Carl Icahn sells everything and criticizes Levine

Hostile Takeover by Dollar General

- FD Shareholders' pressure on CEO
- Combined Dollar General & Family Dollar could be competitor against Wal-Mart
- DG willing to give up 1500 stores or more

Our Prediction

Dollar General does not go through with its hostile takeover; Family Dollar accepts a slightly sweetened deal from Dollar Tree.