Dollar Tree (DLTR) CEO, Gary Philbin on Q2 2019 Results - Earnings Call Transcript

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FQ2: 08-29-19 Earnings Summary

Press Release

EPS of $0.76 misses by $-0.07 | Revenue of $5.74B (3.89% Y/Y) beats by $25.43M

Earning Call Audio

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Dollar Tree Inc. (NASDAQ:DLTR) Q2 2019 Earnings Conference Call August 29, 2019 9:00 AM ET

Company Participants

Gary Philbin - President, Chief Executive Officer

Duncan Mac Naughton - President, Family Dollar

Kevin Wampler - Chief Financial Officer

Randy Guiler - Vice President, Investor Relations

Conference Call Participants

Simeon Gutman - Morgan Stanley

Matthew Boss - JP Morgan

Chuck Grom - Gordon Haskett

Judah Frommer - Credit Suisse

Joe Feldman - Telsey Advisory Group

John Heinbockel - Guggenheim Securities

Karen Short - Barclays

Kelly Bania - BMO Capital Markets

Edward Kelly - Wells Fargo

Operator

Good day and welcome to the Dollar Tree Inc.'s second quarter earnings conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Randy Guiler, Vice President, Investor Relations. Please go ahead, sir.

Randy Guiler

Thank you Cassie. Good morning and welcome to our conference call to discuss Dollar Tree's performance for the second fiscal quarter of 2019. Participating on today's call will be our President and CEO, Gary Philbin; Family Dollar President, Duncan Mac Naughton, and our CFO, Kevin Wampler.

Before we begin, I would like to remind everyone that various remarks that we will make about future expectations, plans and prospects for the company constitute forward-looking statements for the purposes of the Safe Harbor provisions under the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from those indicated by these forward-looking statements as a result of various important factors included in the most recent press release, most recent 8-K, 10-Q and annual report, which are on file with the SEC. We have no obligation to update our forward-looking statements and you should not expect us to do so.

At the end of our prepared remarks, we will open the call to your questions. Please limit your questions to one and one follow-up, if necessary.

Now I'll turn the call over to Gary Philbin, Dollar Tree's President and Chief Executive Officer

Gary Philbin

Thanks Randy. Good morning everyone. As we reported today, the turnaround of the Family Dollar business continues to gain momentum. Family Dollar's same store sales increase of 2.4% was the third consecutive quarter of sequential acceleration and represented 160 basis point improvement in the two-year stacked comp. Despite sales headwinds created by the global helium shortage, Dollar Tree's segment delivered a same stores sales increase of 2.4% while cycling a strong 3.7% increase from the prior year's quarter. Dollar Tree has now delivered 46 consecutive quarters of positive same store sales and eight consecutive quarters of two-year stacked comps exceeding 6%.

I'm proud of the team's accomplishments. During the quarter, we successfully consolidated our store support centers and as planned closed 296 Family Dollar stores as part of the store optimization efforts. Additionally, we completed 542 Family Dollar renovations into the H2 format.

Our results for the second quarter included a sales increase of 3.9% to $5.74 billion. Consolidated same store sales increased 2.4%. Our GAAP EPS of $0.76 exceeded our $0.64 to $0.73 per share guidance range. Other highlights for the quarter included completing 542 Family Dollar H2 renovations, completing 275 Dollar Tree Snack Zones, repurchasing $88.4 million of shares during the quarter as part of our share buyback program.

At the end of July we formally moved all business to the Chesapeake, Virginia campus. This represented the work over the past year to bring all functions, and especially our merchant teams, together. While we still have associates in the moving process, we now have one physical location to conduct our business.

Regarding Dollar Tree sales highlights for the second quarter, Dollar Tree had increases in both traffic and ticket with traffic slightly outpacing the ticket increase. Geographically, all regions comped positively. Cadence of comps through the quarter, all three months were better than 1.5% with June being the strongest month. Dollar Tree continued to deliver solid positive comps in the consumables category. Our discretionary business also comped positive but was impacted by the global helium shortage. We estimate that our comp was negatively impacted from lost balloon sales by approximately 40 basis points. We expect this helium shortage headwind to continue but to a lesser degree in the back half of the year. The first half is more impacted with the timing of our biggest balloon holidays - Valentine's Day, Mother's and Father's Day, as well as school graduations.

For real estate in the second quarter for both segments, we opened a total of 150 new stores, 107 Dollar Trees and 43 Family Dollars. We relocated or expanded 17 Dollar Tree and two Family Dollar stores, we renovated 542 Family Dollar stores as part of our H2 renovation initiative, and we re-bannered 106 Family Dollars to Dollar Tree stores for a total of 817 projects during the quarter. We also added freezers and coolers into 210 Dollar Tree stores during the second quarter, bringing our total of Dollar Tree stores with freezers and coolers to 5,970.

During the quarter, we closed 305 stores, nine Dollar Trees, and consistent with our previously announced efforts to optimize the real estate portfolio, 296 Family Dollar stores. We ended the quarter with 15,115 stores, split into 7,306 Dollar Tree stores and 7,809 Family Dollars.

Last week, we opened up our 24th U.S. distribution center located in Marlow County, Ohio on time, on budget. The 1.2 million square foot facility is creating approximately 400 jobs in central Ohio and will initially be serving Dollar Tree stores. It is equipped with the necessary systems to serve both Dollar Tree and Family Dollar segments in the future. I would call out the partnership and support we received from the State of Ohio, Marlow County, and the surrounding communities has been just outstanding.

Before I turn the call over to Duncan to discuss the Family Dollar business, I'd like to provide you all an update on tariffs.

We have been operating in unique times, to say the least, as it relates to tariffs. As I stated one quarter ago, our merchandising teams have done an outstanding job of mitigating the effects of 25% tariffs imposed under Section 301 for Chinese goods included on Lists 1, 2 and 3. Prior to the recent USTR announcements on List 4, as well as the additional 5% tariff increase on all lists, we believe our team had successfully mitigated most of the adverse effects of the Section 301 tariffs. We have negotiated price concessions, cancelled orders, modified specs, evolved product mix, and diversified vendors. We are now taking actions to mitigate the recently announced tariff increases and will continue to assess the future impact of those tariffs.

Our merchandising team is experienced, committed and talented. They have developed a tested and proven process for mitigating costs and have the metrics in place to track and measure success. The team will continue to focus on delivering great values to our customers while managing and protecting margins.

I'll now turn the call over to Duncan.

Duncan Mac Naughton

Thank you Gary, and good morning everyone. Before I discuss Family Dollar's performance, I'd like to share details regarding a significant organizational milestone that we recently achieved.

Effective July 22, we have successfully consolidated our store support centers into Chesapeake, Virginia. This was a large, complex task that required effective communication, collaboration, and teamwork throughout the organization. I'm proud of our team's attitude, commitment and determination throughout this process. Many of our associates stepped up to relocate with the organization and are now settling into the southeast Virginia area. I'd also like to salute and recognize those who could not or chose not to relocate, but they stayed on through July to facilitate a smooth transition.

The benefits of having our brands together in one location are simply immeasurable. The Family Dollar team is already seeing the benefits from the stability of having a clear vision of the direction and future of our company.

The Family Dollar team delivered another quarter of sequential improvement and comps with a 2.4% increase. The team's performance demonstrates that our efforts to improve the consistency of execution across our stores and our efforts to optimize the real estate portfolio are working and gaining traction. We continue to believe that we're making the right steps to transform our customer experience to increase the frequency of their visits.

Regarding Family Dollar sales highlights for the second quarter, an increase in average ticket drove the same store sales increase in the quarter as year-over-year transaction count was essentially flat. Our consumable business performed very well, delivering its 11th consecutive quarter of positive same store sales.

Regarding the cadence of comps during the quarter, May was up against the strongest compare from a year ago and was slightly positive. June and July were the strongest months of the quarter, and notably year-over-year traffic turned positive. From a regional perspective, comps for all seven zones were better than 1% with the strongest performance in the west, southeast, and southwest.

A few weeks, ago, we conducted Family Dollar's annual leadership conference. This conference brings together our field leadership team and business leaders to teach, to learn, to network and strategize as we prepare for the very important holiday season. The field leadership teams are energized and focused, and they will take that energy back to their respective store teams.

The theme of our 2019 meeting was the Road to Reinvention. We must evolve to be prepared for the future and we're making smart changes and bold changes in our business at Family Dollar. As demonstrated by three consecutive quarters of improved comps, our customers are giving us credit for the improvements they're seeing in our stores, which include our H2 renovations which continue to deliver low double-digit lift, and our grand reopening events are effectively getting the word out to the local communities. Key components of the H2 renovations are $1 Dollar Stop or $1 Wow sections throughout the whole store; more freezer and cooler doors with a broader selection of products; new signage, new décor with improved queuing lines at checkout; better lighting, and much, much more.

Our category resets are working. We're seeing material comp lifts post-reset. Examples of our reset success include candy, household products, and food storage. I'm very proud of the work the teams have done on our private brand offerings with improved labels and packaging. These national brand equivalent, value priced products represent an opportunity to deliver great values to our customers while driving customer loyalty, store traffic, and profit dollars.

At Family Dollar, we are on the road to reinvention. The team has delivered positive comps of 1.4%, 1.9% and 2.4% over the past three quarters, and I am pleased with the additional trends for the third quarter. We have the headquarter move behind us, we have an eager, energized and aligned leadership team, and a terrific plan entering the holiday season. I look forward to providing you more updates on our progress in the quarters ahead.

I will now turn to Kevin to provide more detail on our second quarter performance and our updated outlook for 2019.

Kevin Wampler

Thanks Duncan, and good morning. Total sales for the second quarter increased 3.9% to $5.74 billion, comprised of $2.96 billion at Dollar Tree and $2.78 billion at Family Dollar. Enterprise same store sales increased 2.4% and on a segment basis, same store sales for both Dollar Tree and Family Dollar increased 2.4%. Overall, gross profit was $1.65 billion compared to $1.6 billion in the prior year's quarter.

As a percent of sales, gross margin was 28.7% compared to 30.1% in Q2 of 2018. Gross profit margin for the Dollar Tree segment decreased 70 basis points to 33.8% when compared to the prior year's quarter. Factors impacting the segment's gross margin performance for the quarter included merchandise costs, including freight, increased approximately 55 basis points primarily due to higher domestic outbound freight costs and an increase in the mix of lower margin consumables sold. Distribution costs increased approximately 10 basis points due to higher payroll costs, and occupancy costs increased approximately 5 basis points on the lower comp compared to the prior year.

Gross profit margin for the Family Dollar segment was 23.3% during the second quarter compared to 25.7% in the comparable prior year period. The year-over-year decline was due to the following. Markdown expense increased approximately 100 basis points, resulting from store closure, re-banner and renovation markdowns as anticipated as part of our store optimization process. Merchandise costs, including freight, increased approximately 95 basis points, primarily due to increased sales of lower margin consumable merchandise and slightly higher freight costs. Shrink increased approximately 45 basis points resulting from unfavorable physical inventory results in the current quarter and from changes to the accrual rate.

Consolidated selling, general and administrative expenses as a percent of net sales in the quarter increased 80 basis points to 24% from 23.2% in the same quarter last year. For the second quarter, the SG&A rate for the Dollar Tree segment as a percentage of sales improved to 22.5% compared to 22.6% for the second quarter of 2018. The improvement was due to the following. Store operating costs were lower by approximately 15 basis points due to lower utility costs, specifically electricity resulting primarily from the benefit of the LED lighting program in the stores. Payroll costs increased approximately 10 basis points primarily due to an increase in store hourly payroll due to higher average hourly rate, partially offset by lower retirement plan expenses.

SG&A expenses for the Family Dollar segment were 22.7% as a percentage of sales in the second quarter compared to 21.6% for the same period last year. The increase in SG&A as a percentage of sales was due to the net of the following. Operating and corporate expenses increased approximately 95 basis points, resulting primarily from the loss on disposal of fixed assets due to the store closure write-offs and store supplies expense to support the H2 initiative. Payroll expenses increased approximately 35 basis points primarily due to average hourly rate increases and additional hours, including temporary help expense to support H2 renovations. Depreciation and amortization expense decreased approximately 15 basis points as a result of certain assets becoming fully depreciated or amortized.

Corporate support expenses increased 30 basis points as a result of $10.8 million of store support center consolidation costs and higher depreciation.

On a consolidated basis, operating income was $268.9 million compared with $382.5 million in the same period last year. Operating income margin was 4.7% of sales compared to 6.9% of sales in last year's second quarter.

Non-operating expenses for the quarter totaled $40.5 million, which was comprised primarily of net interest expense.

Our effective tax rate for the quarter was 21.1% compared to 18.9% in the prior year second quarter. The quarter and prior year quarter benefited by $5.8 million and $8.1 million respectively from a reduction in the reserve for uncertain tax positions resulting from statute expirations.

For the second quarter, the company had net income of $180.3 million or $0.76 per diluted shared. This compared to net income of $273.9 million or $1.15 per diluted share in the prior year quarter. Combined cash and cash equivalents at quarter end totaled $623.4 million compared to $422.1 million at the end of fiscal 2018. Our outstanding debt as of August 3, 2019 was $4.3 billion.

During the second quarter, we invested $88.4 million in the repurchase of approximately 882,000 shares. At quarter end, we had $812 million remaining in our share repurchase authorization. We will provide on additional share repurchases, if any, following the quarter in which they occur.

Inventory for the Dollar Tree segment at quarter end increased 15.1% from the same time last year, while selling square footage increased 7.1%. Inventory per selling square foot increased 7.4%. Our inventory levels reflect the early receipt of imports to mitigate tariffs. We believe that current inventory levels are appropriate to support the scheduled new store openings, re-banners, and our sales initiatives for the back half of the year. Inventory for the Family Dollar segment at quarter end decreased 2.3% from the same period last year and increased 3% on a selling square foot basis.

Capital expenditures were $293.3 million in the second quarter versus $213.4 million in the second quarter last year. For fiscal 2019, we're planning for consolidated capital expenditures to be approximately $1 billion, which is consistent with our initial 2019 outlook.

Depreciation and amortization totaled $155.1 million for the second quarter and $152.5 million in the second quarter of last year. For fiscal 2019, we expect consolidated depreciation and amortization to range from $630 million to $640 million.

Our updated outlook for fiscal 2019 includes the following assumptions. Calendar considerations for the remainder of the year include the following. There will be six fewer selling days between Thanksgiving and Christmas, which will negatively impact Q4 sales. With regard to tariffs and the recent USTR announcements, we estimate that without mitigation, List 4a and the additional 5% tariffs on Lists 1, 2 and 3 would cost the company approximately $26 million in additional tariffs. Our updated outlook does not include the recently announced tariff increases as we are currently working to mitigate these costs.

Our company outlook on March 6 of 2019 included $95 million in discrete costs related to our Family Dollar store optimization initiative and our store support center consolidation. With the increased visibility of our overall costs, we now expect to incur $85 million in discrete costs for the year, of which we've incurred $76 million in the first half of the year. Our Q3 outlook includes the remaining estimated $9 million in costs related to these initiatives.

We expect continued pressure on store payroll based on competitive markets, states increasing minimum wage, and completing the company's initiative plans. We expect year-over-year domestic freight costs as a percentage of sales to flatten out in the second half while import freight rates, as we noted in last quarter's call, will increase in the back half of the year.

Net interest expense will be approximately $41.1 million in Q3 and approximately $162.7 million for fiscal 2019.

We cannot predict future currency fluctuations, so we have not adjusted our outlook for currency rate changes. As always, our outlook assumes no additional share repurchases. Our outlook assumes a tax rate of 22.4% for the third quarter and 22.1% for fiscal 2019.

Weighted average diluted share counts are assumed to be 237.5 million shares for Q3 and 237.6 million shares for the full year.

For the third quarter, we are forecasting total sales to range from $5.66 billion to $5.77 billion, and diluted earnings per share in the range of $1.07 to $1.16. These estimates are based on a low single digit increase in same store sales and include approximately $9 million of discrete costs.

For fiscal 2019, we are now forecasting total sales to range between $23.57 billion and $23.79 billion based on a low single digit same stores increase and approximately 1.3% square footage growth. The company anticipates GAAP net income per diluted share for full year fiscal 2019 will range between $4.90 and $5.11, which includes discrete costs of $85 million or $0.28 per share and approximately $15 million or $0.05 per diluted share in store closure related costs.

I'll now turn the call back over to Gary.

Gary Philbin

Thank you Kevin. I'll share a brief update on our early reads from the Dollar Tree Plus test. We are in the very early stages of our multi-price point test at select Dollar Tree stores and will continue to closely monitor the results, including impacts to traffic, sales and margins. Some details related to the test are: launched in mid-May. By the end of June, we had the test rolled out to approximately 115 stores. The test includes newly added products at price points of $2, $3, $4, and $5. The products being tested, which currently include about 200 SKUs, are clearly identified as Dollar Tree Plus items, providing customers more choices, more sizes, more savings. We are testing a cross-section of high, moderate, and low volume stores, as well as urban, suburban and rural settings so we can understand how customers respond in the varying markets.

Early in the test, the product mix has leaned more towards consumables, and this will evolve as we move towards the holiday season with more discretionary items added to the test. We've received feedback on the values from our customers on the initial merchandise assortment, and this is critical as we know we want to protect the Dollar Tree brand. Our customers view Dollar Tree as the destination for terrific value for what you spend in one dollar.

We are pleased with how our teams have started and implemented the test across varied geographies, store volumes, and size. It's giving us valuable insight to how our customers view these values across a Dollar Tree store. Our teams are excited about the evolution of the merchandise assortment as we approach the holiday season. On our most recent import trip, we have bought specifically for Dollar Tree Plus stores and are getting excited about the additional assortment that will resonate with our customers as we go into our holidays.

Finally, I wanted to share a few words regarding our field leadership meetings that I attended in the past few weeks for both Family Dollar and Dollar Tree. This is the opportunity to connect with field leaders face to face, teach and learn, recognize and reward all those individuals and teams for performance and service awards. We interact with buyers and sellers. The merchants and our field team work together. We coach and mentor people development and ensure that we are all aligned heading into the important holiday season. We had very productive meetings, and I'm pleased with the focus and business acumen of our businessmen and women that are leading our field organizations. Our leaders are energetic, focused and motivated going into this important back half.

Operator, we're now ready to take your questions.

Question-and-Answer Session

Operator

[Operator instructions]

We will take our first question from Simeon Gutman with Morgan Stanley.

Simeon Gutman

Thanks, good morning everyone. I wanted to ask about some of the improvement in the Family Dollar comp, to what extent you can tie it to initiatives versus underperforming stores coming out of the comp base versus macro strength, and do you think that we've turned corner here on a higher run rate? I mean, it's been a few quarters now of improved sales.

Duncan Mac Naughton

Yes, good morning and thanks. I'll tell you what, we're pretty excited about the 2.4 comp at Family Dollar. What's most exciting, to your question, is all boats are rising. We're seeing great performance in our H2 stores. To me, what we're seeing is the bulk of the stores are also driving great comp sales, and as I talked about on my prepared remarks, we're now seeing positive traffic across the chain, so that's telling us our customers are liking what we're doing as we clean up our stores.

As you know, we have roughly 1,000 H2 stores out there, and we closed the quarter with 7,809, so the good news here is we have multi years to add, as we're going to talk about, 1,150 or so stores this year, and how do we really change the face of our chain. I would tell you that we can't--with that small store base, we can't run the whole comp, so we're seeing the balance of the chain really help there. We did have some help from store closures, but it was not nearly as impactful as the balance of the chain.

Simeon Gutman

Then a follow-up, I guess on margin and the visibility, at what point does the margin improve and follow this top line? Related to it, can you just share with us on the Dollar Tree side how much helium may have hurt the GM and maybe the EBIT for the Dollar Tree business this quarter?

Kevin Wampler

As we look at the margins and we look to the back half, obviously the front half in particular was loaded with the discrete costs - as we've said, we've incurred about $76 million of what we now believe is $85 million of costs that we will incur. We look for the gross margin to become much more comparable to last year, it's obviously been down. I think the one thing that we have to always consider as we've been driving our business in the Family Dollar world with consumables, and even in Q2 the Dollar Tree business was driven by consumables based upon everything we have going on, touching all these stores that we're touching, so we're driving traffic, we're getting our core customer back into the store in Family Dollar, and they're liking what they're seeing. It's a little bit more consumable driven, so our job that we still have ahead of us is to continue to improve our discretionary business. We do look for the gross margin on the Family Dollar side to start to level out as we go through the back half.

Gary Philbin

Simeon, this is Gary. Let me add my color to that. For both banners, I think it's important as we went into this year, knowing all the stores are going to be torn up for renovations, H2 at Family Dollar, Snack Zones, at Dollar Tree, by the time we were going to get to Q2, we will have touched 1,000-plus stores. By design, not exactly reading the crystal ball as well as you would like, we went in aggressively - close-outs, our Wow product at the Dollar Tree side, a little bit more on consumable side, on the merchandise playing at Family Dollar, so part of that was to make sure we could through, touch these stores, catch them, put them back together, and still drive a positive comp.

As far as balloons, the impact there was the impact of 40 BPs, and that's really just on what we lost on balloon sales in the first half--or in the second quarter year-over-year. Obviously first half, as I called out, is a little more impactful. What we didn't measure was balloon sales usually have a halo effect of everything else in the party department, which is obviously one of our highest margin and a very large business, and it really drives customers to that store. We know it's not going to be as impactful because the holidays aren't as big, and we'd like to think it's going to get moderately better as we go into '20, but that was probably the best way to measure the balloon impact.

Operator

We'll take our next question from Matthew Boss with JP Morgan.

Matthew Boss

Thanks, and nice progress, guys. First at Family Dollar, how best to think about sequential same store sales improvement opportunity in the back half of the year? Maybe what do you see as top drivers of the traffic inflection at your H2 remodels, and any color on early 3Q trends would be helpful.

Duncan Mac Naughton

I'll tell you what, Matt - thanks for the question. As you can see, our engine is growing, our traffic is turning positive, and we're driving some real growth with consumables, and our job is to convert that to the discretionary side of the store to enhance our margin throughout the year. We've got a really strong back half plan and a strong holiday plan that we just shared with our leaders at the annual leadership conference, and I think year-over-year you're going to see us continue to strive to grow our comps as we get more H2s on the ground, they mature, and we're seeing in the balance of the stores is they're really starting to have higher standards at store level, so the stores are getting cleaned up, the customer is noticing, and they're getting the components of some of the H2 stores while they may not be an H2 store. So we're trying to fast adapt as we learn what are the key winners and key categories.

We did a number of resets last year that are now going to start cycling and be helpful to the comp in the back half, so I feel pretty good about our business plan with comps as we look forward.

Gary Philbin

Matt, it's Gary. I would just add, that's part of the energy and why we added more H2s. A shout-out to our openers has gotten us ahead of the game to this point to get the 1,000 done by the time we finish up August here, Labor Day weekend, and we had some more runway so we're up for another 150 to get done mainly through September, a little bit probably into October to give us more H2s on the ground. But to give credit to the Family Dollar team, the consistency of what we're seeing in stores, the work we've done on key resets, I think what we see is lifting all boats right now.

Matthew Boss

Great. Then as a follow-up, just to help break down margins, could you bucket the discrete the costs at Family Dollar between the gross margin and the SG&A, both what you saw in the second quarter, how to think about the back half, and larger picture what's the best way to think about Family Dollar's fundamental gross margin recapture opportunity that you see from here?

Kevin Wampler

Hey Matt, it's Kevin. In my prepared remarks, I tried to give some good color on this, so let's break it down into pieces here if we can. Obviously within the press release, we talked about $48 million of discrete costs within the quarter as well as $15 million of store closure costs, so that's a total of $63 million or about 230 basis points. If you take out the $10 million of store consolidation expenses, that means about $52 million sat within the Family Dollar segment, and as we called out within the prepared remarks, that's about 190 BPs. That basically broke down really about 100 BPs of markdowns, which we talked about, so you're talking about all the store closures, all the renovations, all the re-banners, everything related around that from that piece. Then on the SG&A side of it, it's all of the asset write-off for all the store closures. Again, we closed 296 stores during the quarter, supplies for the H2 renovations as well as labor, temp labor for the H2 renovations as well, so that's roughly 90, 95 BPs. That's kind of how to bucket-ize them the best way and the big picture way.

As far as a go-forward margin, we have huge opportunities. Obviously it's been a disappointing year from shrink perspective, and we have a lot of opportunity go forward. As we talked about last quarter, look for it to start to flatten out in the back half on a comparative basis. A lot of initiatives in process there relating to, one, just changes in leadership and structure, really working on our commitment to training, execution of our policies and procedures, defensive merchandising initiatives, analytics, and again getting our inventory levels down as well will be very, very helpful in that regard. So I think we have a huge opportunity as we go into next year to help our gross margin in that regard.

Gary Philbin

Matt, let me just chime in because I think--just a couple call-outs when I think about it. First off, with increased traffic we can steer this boat, and that's what the H2s are doing and what we're starting to see better in the rest of the fleet, and so an opportunity when somebody comes through the store and selling the compelling merchandise on the discretionary side becomes all the easier. Secondly, I've got to just tell you, having everybody in the same building now and the merchant teams on the same floor, vendors now meeting both banners at the same time, I can't tell you how excited I am about that. We are a $25 billion company with a face to the vendor community. We can drive sales, and we'll be on the short list of people to come to, to do that.

Finally, just a continued piece on imports, forgetting tariffs for a second if we can, the opportunity to design and create value merchandise that sells at both Family Dollar and Dollar Tree is a big, big impact for us as we look forward.

Operator

Once again, if you find your question has been answered, you may remove yourself from the queue by pressing star followed by two.

We'll take our next question from Chuck Grom with Gordon Haskett.

Chuck Grom

Thanks, good morning. Duncan, I was wondering if you could amplify on the improvement in traffic in the quarter. Do you think it's new customers that you're gaining, or is it existing customers repeating? Then one for Kevin, just a follow-up on Matt's question because there's been a lot of confusion on the gross margin line in Family Dollar. I was wondering if I could ask it from a different way. Can you look at the one-time costs, both the discrete and the store closures, what that was from a basis point impact versus the normal course of business, i.e. shrink and any markdown activity? Thanks.

Duncan Mac Naughton

Thanks Chuck. As for Family Dollar traffic, I will tell you, as we talked about low double digit lifts in our H2 stores, about two-thirds of that is coming from traffic, so we're seeing transactions go up there and we're seeing a lot of repeat purchases coming. Part of that as we study the marketplace, we know we're acquiring some new customers from some other folks in the marketplace, so I will tell you that part of it is both our existing customer coming back more often and then getting and acquiring new customers that may have been a Family Dollar customer, and through our grand reopening initiative, as we communicate back to them that we've got a new Family Dollar for you, why don't you come check it out, and they see what we have to offer and where they may have stopped shopping with us, they come back to us. We feel real good about that pattern, so.

In the balance of the chain, we're seeing--I think people are seeing that our store standards have been better and they're seeing that we've been pretty aggressive with our growth in consumables, and we're working on the discretionary side of the business as Gary talked about, to move that customer over.

We've also modified our marketing campaign to have more frequency so that we can be in the marketplace more often, which I'm excited about because we've got a gap there before, so that will close that gap. I would tell you that in the H2s, it's some new customers and the rest of the chain, it's both. I think the good news is trips are going up.

Kevin Wampler

Chuck, in regards to your question relating to the Family Dollar margin, again it's really three buckets related to the change year-over-year for the quarter. Again, it was 100 basis points from markdowns related to the initiatives, about 95 basis points related to increased sales of lower margin goods, a slightly higher freight, and then about 45 basis points related to shrink. It's really kind of the three buckets as we've put them in and can best describe for you. I don't know if there's something beyond that that you're looking for?

Chuck Grom

No, that's helpful. I just wanted to get all the information. Then on the Tree, just maybe unpack for us the difference between the first and the second quarter gross margin performance and how you're thinking about it in the back half of the year. Thanks.

Kevin Wampler

I think if you look at the first quarter, gross profit was roughly flat year over year versus this quarter, so we were impacted more by freight in this quarter than we were the first quarter. Again, a little bit of timing, a little bit of what we've got going on. Again, we did build inventory as well during the quarter from an import standpoint to mitigate tariffs, so there's some effect from that a little bit, but overall as we look at it, I think the idea of freight was the bigger piece.

We do look for that to mitigate a little bit as we go through the back half, as we've said. Then the other piece as we've called out was really the idea that we did sell--we had a better consumable business in the second quarter, so our sales mix, our margin mix averaged a little lower at the end of the day because of the overall consumables mix. As we go forward, I don't know--as I said, I don't think that we'd necessarily expect to see the same type of pressure that we saw in Q2.

Gary Philbin

Chuck, I would just give you some color. I think really the last two years, our seasons have gotten out the gates very quickly and performed very well. All this inventory we brought in to beat the tariffs is there - that's the imports, it's higher margin. As we kick off really the fall harvest season as we get past Labor Day, to me we are set up to take advantage of what Dollar Tree does best, and that's getting geared up on the discretionary side of the business. We've invested in consumables to make sure we had the kind of traffic and customer count we needed as we went through all of our Snack Zones. Snack Zones are delivering what we thought across the network, and now let's shift gears a little bit back to what the best time of the year is for Dollar Tree, and that's really September, October on through the Christmas holiday.

Operator

Once again, if you would please limit your questions to one question and one follow-up if needed.

We will take our next question from Judah Frommer with Credit Suisse.

Judah Frommer

Thanks for taking my question. First to circle back to tariffs, it sounds like you've quantified the potential impact from the increase on Lists 1 through 3 and List 4a, but it's not embedded in the 2019 guide. Is the messaging that you do feel you can fully offset that, or is the message that you're working to offset and you'll update us with the magnitude of offset at some point?

Gary Philbin

Thanks Judah. Yes is the short answer. Listen, we're six days from the last change, so here's how we've gone through the year. The merchant teams had mitigated Lists 1, 2 and 3, as we knew it, then when List 4a, 4b first came out we had plans on that, and actually on our trip to Asia felt very good about where we were on that. Then of course, the most recent changes make that the call out of our most recent new.

Well, the things we're doing are working pretty darn well. I would say the vendor community is stepping up. We have done things like we've said before, we can--we've really worked hard on changing how we're packing things or the packaging, and how many units can we get on containers so we can land the overall cost lower. We've been able to move, I would say modestly, $100 million on some of the buying trips out of China with our strategy of China-plus-1. I give credit to our merchants - this is about negotiating a vendor at a time to make those differences, and that's why I went into this call. We wanted to give you the math to give you some sense of the scale, and really while it's work we've got to do from six days ago, I have confidence in the group that we'll mitigate it for the balance of the year.

Judah Frommer

Okay, great. Kevin, you were kind enough with Q4 earnings to give us an early read on next year and the earnings growth related to that. I think you've been clear that you guys guide on a GAAP basis, but GAAP earnings have moved around quarter to quarter as discrete costs come and go. Is there any directional update you can give us on how you're thinking about that earnings growth trajectory for next year?

Kevin Wampler

We haven't updated the guidance we gave back in March on that subject. Obviously we're just kicking off our budget season right now as we speak, basically for next year, and I don't think--in the simplest terms, I don't think anything in the base has changed. I think we have the unknown of tariffs and where they go and what they may do. I don't know that any of us have an answer for that at this point in time. We'll have to take that into consideration accordingly. But I would tell you, the base case, I don't see necessarily a change in our thought process.

Judah Frommer

Okay, thanks.

Operator

Your next question is from Joe Feldman with the Telsey Group.

Joe Feldman

Hi guys, thanks for taking my question. I wanted to ask, with regard to the new front end that you have at the Family Dollar side of the business, how many stores have that at this point, and how fast can you get that to all the stores?

Duncan Mac Naughton

Hey Joe, thanks for the question, this is Duncan. We've got it obviously in all H2 stores and we're putting it in all our new stores as well. The key constraint at store level is the size first and the width second. We do have multiple formats of the queuing line, so I will tell you that where we can, we're putting it in because it is very profitable to the store, not only the single serve beverages that are there but then again that front end is quite profitable both on the snack side, as well as you've probably noticed we've been putting discretionary items on there. The team right now is testing another front queuing line that will actually enhance profitability for that front end and really fit the needs of our customer, I think, better. It's primarily an H2 initiative at this point, is where we're focused. Where we're doing any other kind of renovations, we'll see if it can be accommodated, but it's really the H2 number.

Joe Feldman

Got it, thanks. Then also, just a question on the DCs. I know you guys just opened a 24th new DC, and you made a comment that it's set up for both but you're only going to start with the Dollar Tree. Can you remind us where you're at with how many co-branded DCs that you do have at this point, and how many you want to have?

Gary Philbin

Well, we have one DC that is in Utah that distributes to both Family Dollar and Dollar Tree. We now have four additional DCs that have the internal workings and warehouse management system that allows us to deliver to both. We've needed the capacity for the Dollar Tree banner because we have capacity in the Family Dollar network because of the closures, the re-banners, and of course that's putting pressure on the Dollar Tree banner. Ultimately, it comes down to the size of the building, any new building that we've done comes now with the ability to deliver either banner, which will be a place that we move to and that's a stem mile opportunity for us in the out years. It's right now a function of capacity needed for our Dollar Tree banner to make sure we can service those stores, and we pick up obviously some stem miles every time we open up a Dollar Tree banner because we have more stores closer to that.

Operator

Our next question comes from John Heinbockel with Guggenheim Securities.

John Heinbockel

Two quick things. I know there's not a lot of H2s with a lengthy history, but do you guys have a sense of how that format will mature and waterfall in years two and three, comp-wise? Do you think it's above maybe what a new store would do, a normal new store that settles into a more normal waterfall?

Duncan Mac Naughton

Hey John, it's Duncan. Thanks for the question. I think it'd probably comp like a regular new store, is what we're thinking about, and we've got a handful of them that have kind of cycled themselves, so we're learning quickly. But it's behaving like a new store.

John Heinbockel

Okay. Then maybe for Gary, again I know that multi price point is in its early stages here, but have you found anything interesting when you look at the basket construct of people who have a Dollar Tree Plus item in there versus those who don't? Are there fewer items when they buy a Dollar Tree Plus? How is it different?

Gary Philbin

Thanks John. I would say at this point, it's purely additive to the basket. It's telling us I'm a Dollar Tree shopper, I come in, I like my regular items and now here is something that surprised me, is some of the feedback we hear. That goes into what was, quote-unquote, their regular basket. I think we've started off with some items that are giving us some pretty good information how our customer views it, but what I'm really maybe most excited about is putting a bit more of the Dollar Tree whimsy and surprise of the Wow effect into some of the items, and that will give us another very into what customers are buying, especially as we get around holiday time. So more to come - we've bought specifically for these stores, and they'll be in addition to the assortment as we continue to evolve and get the best read we can.

John Heinbockel

Okay, thank you.

Operator

We have time for a few more questions. Our next question comes from Karen Short with Barclays.

Karen Short

Hi, thanks for taking my question. I just wanted to clarify a couple of things. You commented that you were pleased with 3Q trends at Family Dollar, so I just want to clarify, is that to be interpreted that comps are above where you came in, in 2Q? Then I had another clarification on guidance.

Kevin Wampler

Duncan made that comment. Obviously we're only three weeks in, so it's not like we're going to give a whole lot of other information, but we're pleased, is what we would state. We're not going to make a statement whether it's higher or lower or what it might be, but we're very pleased at this point.

Karen Short

Okay, and then just with respect to guidance--not guidance, but I guess loose commentary on 2020, there's just a little confusion with respect to the comments you made in March. I'm asking this question excluding tariffs, but when you think about that 14% to 18%, are you looking at a number that's based on GAAP EPS or adjusted EPS?

Kevin Wampler

We've always said it's based upon GAAP EPS.

Karen Short

Okay, great. Thank you.

Operator

Our next question comes from Kelly Bania with BMO Capital Markets.

Kelly Bania

Hi, good morning. Thanks for fitting me into the questions. Just wanted to ask about tariffs. It was helpful to have the quantification, I guess, of the $26 million over the next couple of months. I'm guessing in terms of List 4 that you're still working through that, which is why that wasn't quantified, but maybe you can just talk about order of magnitude, how that would compare to what you're quantifying today, if you can at all? I guess a couple of other questions related to that - how much have you saved with respect to tariffs by bringing inventory early at multiple points throughout this year, and then is there at all an upper limit to what you think your team can offset here? Do you feel confident that as even as you get into next year, that this can further be mitigated? Thank you.

Gary Philbin

Hi Kelly. Listen, we're managing to what we know, let's start there. I think what we tried to paint a picture of, the magnitude for this 4a when we knew it was initially 10%, that was in our sights and the team went to work right away on 4a knowing that 4b was coming. We had more time on 4b. Once the tariff was increased for both List 4 and Lists 1, 2 and 3, we just are continuing to do the same playbook that's been working for us, everything that I had called out before. You know, we're in unique times, and we're in unique times where I think the opportunity is, I would tell you our vendor community is both--wants to work through this and help at this moment in time, and part of it is they're also concerned they might lose business, and some have as we have found other opportunities either inside China or outside China. There is never just one tune you play to overcome this.

What gives me confidence for the balance of this year is I can see the rocks in front of me, and our teams have worked real hard to overcome what we see this year.

To a comment on '20, shoot, I'm trying to think about what might happen this week or next week. But we are working real hard on what we know today based on the USTR as we go into what's going to be a first increase on September 1, knowing that there's another one in October and then finally December 15. Those are the ones that we know of right now.

Kelly Bania

Just on the inventory, how much has been mitigated by just bringing inventory in early?

Gary Philbin

In scale of what we sell, we try to bring items in. It's not a huge amount. I mean, of course you try to bring it in if it's on the water, but keeping in mind it's six weeks before you leave a port and you get somewhere else, and we're often not given six weeks to make much of a move. If we can do anything, we do, but it's not meaningful on the scale of what we're talking about on cost of goods and the tariffs.

Operator

Our final question comes from Edward Kelly with Wells Fargo.

Edward Kelly

Yes, hi guys. Good morning. Just a few questions for you. First, I just wanted to ask you about store manager turnover at Family Dollar. I was hoping you could give us an update on the progress that you're making there and the initiatives that you in place to improve that.

Duncan Mac Naughton

Hey Edward, it's Duncan. Thanks for the question. I will tell you that store manager turnover has improved slightly. We're still at a level that I'm not happy with, but last year we focused all our training and our field meeting on Year of the Manager, which was all about training our people, giving them tools, about hiring the right person, training the right person, and retaining the right person. We gave them many tools and consistent playbooks across the chain to do that, and they've all been trained on that. We highlighted it again this year and updated those toolkits, and we've had national recruiting fairs, as you're probably aware, and we've made progress there. It does attract a fair amount of people.

Gary Philbin

I would just have to call out, with some of the same efforts, Dollar Tree is going to have one of its best three years ever since I've been here on store manager turnover. I think the initiatives are well focused and pointed at the right things, and we're working real hard to get both banners to what ought to be a banner year on store manager turnover.

Edward Kelly

Great. Just a follow-up on Dollar Tree Plus, any color you can provide on timing around a decision in terms of your assessment of the initiatives, and then do tariffs at all--an escalation of tariffs impact strategically how you're thinking about the Plus format?

Gary Philbin

Well on the timing side, I think as we get and evolve the assortment, we're going to learn more, so I can't quite give you a timeline. I'm more interested in what can I learn from giving our customers an evolving assortment that will tell us more--that resonates with her when she's in a Dollar Tree.

As far as tariffs, obviously anybody out there today who's importing is affected no matter what the price point, it obviously goes into the equation, but it does make you take a look at where you're buying from. But to hit the mark, you have to really focus on what the customer wants, as always in retail, and for our Dollar Tree stores, how does that play out when we take a look at retails that go up to $5. I think that's really what we're focused on - what's our Dollar Tree customer going to look for in our world, and that's what our merchandising teams are very focused on. Thank you.

Operator

That concludes today's question and answer session. Mr. Guiler, at this time I will turn the conference back to you for any additional or closing remarks.

Randy Guiler

Thank you Cassie, and thank you for joining us for today's call and for your continued interest in Dollar Tree. Our next quarterly earnings conference call to discuss Q3 results is tentatively scheduled for Tuesday, November 26, 2019. Thank you.

Operator

That concludes today's presentation. Thank you for your participation. You may now disconnect.