HEDGE FUNDS SEE BARGAINS IN DISCOUNT RETAIL

Smart money buys into dollar stores as shoppers snap up low-priced merchandise in tough economic times

BY JESSICA WOHL
CHICAGO, JUNE 1

WITH GAS PRICES and unemployment high, low-income shoppers are not the only ones trying to find the best bargains in discount stores.

Some of the largest stock-picking hedge funds jumped into Dollar General Corp, Family Dollar Stores Inc and Big Lots Inc during the first quarter as a string of reports suggested low-priced retailers were ripe for takeover deals.

And though the M&A news has been mixed at best, the group got another jolt on May 25 when Pershing Square's Bill Ackman said he was buying shares of Family Dollar. “It's a business that continues to take share even in recessionary environments,” Ackman told the Ira Sohn Investment Conference in New York. “We think it's quite an attractive LBO,” he added later in his speech.

Even without the potential for takeovers, expectations are high that discount retailers, particularly the so-called dollar stores, will keep winning over low-income shoppers.

“They're just in the sweet spot right now,” said Wells Fargo analyst Matt Nemer. “Their
prices are really very, very low and they have convenient locations that you don't have to spend a lot of gas to get to."

Funds including James Dinan's York Capital Management, Steve Mandel's Lone Pine Capital and Eric Mindich's Eton Park Capital Management bought into or increased their positions in one or more of the chains in the first quarter, according to Thomson Reuters data.

Dollar General and Family Dollar sell everything from milk to clothing in thousands of small stores. Wal-Mart Stores Inc and others may offer better prices, but their stores can be hard to reach and their larger packages cost too much for those on tight budgets, especially as paychecks run low.

"To the extent that customers are living paycheck to paycheck ... it's nice to be able to buy one bar of soap," said Nemer.

Though rising wholesale prices have squeezed retailers, dollar stores can win as inflation hits food, clothing and other goods. Shoppers looking for low prices visit more often, leading to higher overall sales, and many of them switch to less expensive private label goods, which have higher margins.

Analysts largely prefer Dollar General. Nemer likes that it can continue to pay down debt, which locks in some earnings growth.

Richard Chilton's Chilton Investment and Alan Fournier's Pennant Capital opened new positions in Dollar General in the first quarter, while Mandel's Lone Pine Capital and Thomas Steyer's Farallon Capital raised existing stakes. Lee Ainslie's Maverick Capital was the only member of the Smart Money 30, a group of some of the largest stock-picking hedge funds, to cut back on the stock.

Majority-owned by private equity firm Kohlberg Kravis Roberts & Co LP, Dollar General is also further along than competitors in improving its lineup of private label and discretionary items.

Most people see private label items as comparable to branded goods, said Avondale Partners analyst Mark Montagna.

Wal-Mart and Target Corp are trying out smaller stores, but Dollar General and Family Dollar already know how to run such shops, and they keep opening more.

Dollar General has about 9,500 stores in 35 U.S. states, more stores than any other U.S. retailer. It plans to enter four more states, including California, sometime next year.

Chairman and CEO Rick Dreiling said he

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**Family Dollar's fiscal year ends on the last Saturday of August.**

**U.S. discount chain only.**

Source: Company reports, Thomson Reuters

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**SIDEWALK SALE:** Shopping carts laden with clearance merchandise stand outside a Family Dollar store in Mar Lin, Pennsylvania, on May 30, 2011.  REUTERS/LISA VON AHN
sees opportunities for 12,000 more Dollar General stores across the country.

Those who prefer Family Dollar like the room it has to improve, in part because selling more of its own branded goods will help increase its margins.

Funds run by John Paulson and Eric Mindich added new positions in Family Dollar in the first quarter, as did York Capital and Glenview Capital. Mandel’s Lone Pine increased its holdings.

Family Dollar delivered some of the mixed M&A news in March when it rejected a takeover offer from Nelson Peltz’s Trian Group. Dollar General has stayed silent on whether it will try to buy its smaller rival.

"I would consider it to be fairly valued at this point," Larry Carroll, president of Carroll Financial in Charlotte, North Carolina, said of Family Dollar. "It’s not cheap, it’s not expensive."

Ackman’s excitement about the company sent the shares to new highs in late May of around $55, just at the low end of the range of $55 to $60 Trian was ready to pay.

Many do not expect longtime Family Dollar Chairman and CEO Howard Levine to walk away from the business his father started back in 1959. He wants to grow the company on its own by renovating older stores and aggressively opening new ones.

"There’s probably a 30 to 40 percent chance that you actually see a (Trian) deal," said Carroll, whose firm has about 50,000 Family Dollar shares after selling some when the stock was between $52 and $54.

York, Eton and ESL Investments -- the fund owned by Sears Holdings Corp Chairman Edward Lampert -- all bought shares of close-out chain Big Lots during the first quarter.

Big Lots sells goods that were overproduced, discontinued or rejected by other retailers, making it more of a "treasure hunt" shop for those with some extra money to spend.

Its shares plunged in mid-May on reports that it was taking itself off the auction block after failing to attract high enough bids. Big Lots then cut its fiscal-year profit and sales forecasts and announced plans to buy a Canadian chain.

(Editing by Aaron Pressman and John Wallace)
ALYESKA'S PAREKH RUNS AHEAD OF THE PACK

ANALYSTS WHO COVER initial public offerings had little enthusiasm for first-quarter deals for debt-laden companies like hospital chain HCA Holdings Inc and pipeline operator Kinder Morgan Inc.

But up-and-coming Chicago hedge fund manager Anand Parekh saw value in proven businesses throwing off hefty cash flows.

In the first quarter, Parekh bought stakes in HCA, Kinder Morgan, Nielsen Holdings and others that were going public after having been taken private in leveraged buyout deals over the past few years.

That made Parekh’s Alyeska Investment Group the top buyer of IPO stakes in the Smart Money 30 group of some of the largest stock-picking hedge funds, according to data compiled by Thomson Reuters.

And so far, most of the bets are paying off for Alyeska, a fund that maintains a lower public profile than some of its competitors. HCA is up 17 percent from its IPO price and Nielsen is up 37 percent. Kinder has slipped 4 percent.

Parekh, who opened Alyeska in early 2008, follows a market neutral strategy that sells stocks short as well as buying long positions.
The firm, which manages $2.5 billion to $3 billion, does not disclose its short positions, and Parekh declined to comment.

The fund’s impressive growth in assets has been driven by steady, positive returns every year since it started, a record that has gained attention considering the stock market’s sharp declines in late 2008 and early 2009.

Parekh, a 38-year-old from northern New Jersey, is an avid runner who has competed in a number of marathons, including Chicago several times. His best Chicago time was 3:21:16 in 2006.

The Alyeska fund is named after an Aleut word that means “big country” and that gave the state of Alaska, where Parekh’s wife grew up, its name.

Parekh has attracted strong talent while instilling a disciplined investment style and firm risk controls, according to a person familiar with the fund who was not authorized to speak publicly.

Before starting his fund, he gained a reputation as a savvy investor at Citadel Investment Group, where he was global head of equities. Before joining Citadel in 2003, he headed North American structuring for credit and interest-rate products at Deutsche Bank and was earlier in charge of risk management in the bank’s London office.

Parekh, who graduated from the University of Michigan with degrees in English and mathematics, is discerning about who invests in the fund and those he hires.

“He’s a very dynamic individual who draws people to him,” said a former colleague who was close to Parekh. “He’s very thoughtful about how to build an organization and how people can fit together. And he is able to keep different people who have high aspirations (and) inspire (them) to work together in a team format.”

MANY IPOs

ALYESKA’S LONG POSITIONS are mostly liquid, large-cap stocks in a portfolio of about 260 securities including options, according to its latest filings with the U.S. Securities and Exchange Commission.

The fund added four big new names in the first quarter. The largest was Genzyme Corp, which was acquired by pharmaceutical giant Sanofi SA in April. Other top new additions were insurer MetLife Inc, HCA and drugmaker Pfizer Inc. Alyeska increased large stakes in Walt Disney Co and Target Corp as well.

An examination of Alyeska’s first-quarter holdings showed the fund bought into a

TARGET SHOPPER: A customer studies her receipt during Black Friday sales at the Eagle Rock Plaza in the Eagle Rock area of Los Angeles on Nov 26, 2010. REUTERS/ PHIL MCCARTEN
number of initial public offerings that were backed by private equity, a strategy that has proven successful, according to research by Thomson Reuters.

Private equity-backed companies that went public returned, on average, 52 percent to investors, compared with a 35 percent return for IPOs that were not backed by private equity.

Since 2009, almost half of the 204 IPOs without private equity backing traded below their offering price. But only 20 percent of the companies taken public by private equity sponsors have dipped below their IPO price.

A person familiar with Alyeska said Parekh does not explicitly seek out so-called reverse LBO IPOs. Instead, fundamental research drives individual stock selection at Alyeska, the source said.

Of the 19 companies Thomson Reuters identified as private equity-backed IPOs, only HCA was big enough to be among Alyeska’s top 10 holdings. A number had market caps of less than $1 billion, and Alyeska’s stake was small.

Reverse LBO IPOs shine thanks to the strong management teams private equity firms recruit to run the businesses, said Rick Fearon, a former executive at private equity firm Allied Capital who later founded hedge fund Accretive Capital Partners in Madison, Connecticut. The companies also typically get a sharp makeover while they are still private.

“These initiatives often provide sustainable comparative and competitive advantages, creating a moat around the business which benefits new shareholders as well,” Fearon said.

(Editing by Aaron Pressman and John Wallace)
Yahoo CEO Carol Bartz is known as a strong-willed and straight-talking leader, but some top money managers are betting she can mend fences and compromise with crucial partners in China.

Shares of Yahoo Inc, at around $16, are just over half what they were in 2008 when Microsoft came calling, never mind the Internet bubble highs of a decade ago.

But the stock's potential rebound attracted top hedge fund managers David Einhorn of Greenlight Capital, Philippe Laffont of Coatue Capital, Anand Parekh of Alyeska Investment Group and Ricky Sandler of Eminence Capital in the first quarter. The buying spree made Yahoo one of the biggest additions to portfolios of the Smart Money 30, a group of the largest stock-picking hedge funds, according to Thomson Reuters data.

Analysts say most investors have undervalued the most exciting part Bartz's Yahoo portfolio: its substantial Asian assets, which include a 43 percent stake in China's Alibaba Group and a 35 percent stake in Yahoo Japan.

But Bartz has had a tough time dealing with some of her Asian partners, particularly Alibaba Group founder Jack Ma, as investors discovered in early May.

That's when Yahoo revealed that online payment company Alipay, an important piece of its Chinese investment, had slipped through its fingers as a result of an asset transfer that raised questions about what kind of payout Yahoo's Asia assets will deliver. Yahoo shares tumbled 12 percent in the days that followed.

Bartz got off to a bad start with Ma, a former English schoolteacher, by criticizing his management of Yahoo's brand in China during their first meeting in 2009, according to a person familiar with the matter.

And Ma was subsequently rebuffed in efforts to repurchase some of Yahoo's stake in his company.

But the Alipay transfer was in fact a case of “bad news is good news,” according to Adam Seessel, portfolio manager of the RiverPark/Gravity Long-Biased Fund, which counts Yahoo as its largest position.

Ma values his reputation on the world business stage too much to try to wrest control of the assets away from Yahoo without offering compensation, Seessel said. Instead, he reckons Ma will use his leverage to force Bartz's hand at the negotiating table and make Yahoo sell back its entire 40 percent stake in Alibaba.

"There's no risk that they're going to lose these assets," he said of Yahoo. "What's happened is the timetable for monetizing these assets has been radically shortened because Jack Ma wants his stake back."

To be sure, the scenario seems too risky for some investors.

"There's more uncertainty in terms of will Yahoo be able to get the full value of these assets," said Aaron Kessler, an analyst at ThinkEquity. But he noted that with Yahoo
shares currently trading at around $16, the market isn’t assuming much value for the Chinese assets to begin with, leaving room for upside.

Daniel Morgan, a portfolio manager at Synovus Trust Co, said he was more interested in seeing a turnaround in Yahoo’s core business than he was in gambling on a potential payoff from Yahoo’s Asian assets, particularly in the wake of the Alipay situation.

“There’s got to be more to it than just speculation surrounding something that could happen,” he said.

Still, the allure of China, the world’s largest Internet market by number of users, is hard to resist. Shares of Baidu Inc, China’s No. 1 search engine, have surged 32 this year, while Chinese Web portals SINA Corp and Sohu.com Inc have risen 59 percent and 24 percent, respectively.

While Western Internet companies like Google Inc have struggled to crack the Chinese market, notorious for its murky regulatory landscape, Yahoo’s partnership with local player Alibaba was considered a shrewd way to tap into the fast-growing Chinese market -- particularly given that Yahoo acquired its sizable stake in Alibaba for the bargain price of $1 billion in 2005. Some investors believe privately-held Alibaba’s value currently exceeds $40 billion.

The fate of Taobao, an Alibaba subsidiary that is considered the eBay of China and deemed more valuable than Alipay, could be of even greater concern to Yahoo investors.

Some investors, such as RCM Capital Management Portfolio Manager Walt Price, believe Taobao could be poised for an initial public offering in 2012, providing a boost to Yahoo’s shares.

Price doesn’t see much risk of the Chinese government barring Yahoo from owning a stake in Taobao, as occurred with Alipay, noting that the e-commerce industry is of less concern to Chinese authorities than payment businesses. But he said Bartz and company need to make nice with Alibaba to clear the way for a Taobao IPO.

“They just have to repair the relationship and compromise maybe a little bit on the ownership structure. If they do that, they’re going to own one of the most valuable companies in China and Yahoo’s stock is going to go higher.”

It’s not the first time that Yahoo’s fortunes have been closely intertwined with another Internet juggernaut. Yahoo shares reached $30 in 2008 amid negotiations about an acquisition by Microsoft Corp.

Yahoo co-founder and then CEO Jerry Yang rebuffed a $47.5 billion offer by Microsoft, sending Yahoo shares on a downward slide from which they have never recovered.

This time around, investors betting on the pioneering Web company expect Bartz to close the deal.

(Editing by Aaron Pressman and John Wallace)
MARATHON OIL CORP Chief Executive Clarence Cazalot’s second attempt to spin off his refining business has attracted some top hedge funds eager for a two-fer of their own.

David Tepper’s Appaloosa Management, Eric Mindich’s Eton Park Capital and Jeff Altman’s Owl Creek Asset Management were among funds snapping up shares of Marathon in the first quarter after Cazalot announced his plans.

That helped make Marathon one of the largest new holdings in the Smart Money 30 group of the largest stock-picking equity funds, according to Thomson Reuters data. The group increased its overall weighting of energy sector stocks by 0.6 percentage point, the largest rise for any sector in the first quarter.

The short-term bet on Marathon centers on the June 30 refinery spin-off, which revives an unsuccessful 2008 plan to unlock higher valuations for both parts of the company. And over the long-term, Marathon’s oil assets offer a targeted play on continued high prices, analysts said.

“The transaction will unlock value for shareholders,” said Ann Kohler, an analyst at CRT Capital Group who rates the shares “buy.” “Right now, the independents and refiners trade at a higher multiple.”

As an integrated company -- one with both refining and exploration businesses -- Marathon’s enterprise value is equal to just 3.8 times its earnings before interest, taxes, depreciation and amortization, or EBITDA.

By that measure, large exploration companies trade at multiples around 6, and refiners with no exploration units trade at multiples around 5, Kohler said.

Marathon trades at a price to earnings ratio of 8, below peers like Devon Energy Corp, Occidental Petroleum Corp and Hess Corp, which trade at multiples of 10 to 14.

To be sure, some of the expected gain has already crept into Marathon’s stock...
price. The shares have outperformed peers since the spinoff announcement in January, gaining more than 20 percent, compared with a 4 percent gain in the CBOE index of oil companies.

The revamping will be the second generation of downsizing for Marathon, which was itself spun off from U.S. Steel Corp in 2002, two decades after U.S. Steel purchased the company.

After June, shareholders will own a pure energy exploration company with a heavy focus on oil that will keep the name Marathon Oil Corp.

For every two Marathon shares they own, investors will receive one share in the refining company, Marathon Petroleum Corp, which has sophisticated plants capable of processing cheaper grades of crude as well as access to U.S. export markets.

Marathon Petroleum Corp also gets the Speedway gas station chain and will issue up to $3 billion of new debt, with proceeds above $750 million going back to the parent company to pay off some of its existing debt.

Cazalot, a geophysicist who ran Texaco's worldwide production operations before joining Marathon in 2000, will stick with the oil business. Gary Heminger, the current head of refining, will become CEO of Marathon Petroleum Corp.

The refining business, which will be the second-largest independent refiner after Valero Energy following the transaction, is well run and will benefit investors as a stand-alone company, analysts said.

"Marathon's refining system has ranked within the top five for income per barrel," CRT’s Kohler said, reviewing the almost 60 competitors in that market. "It's a very well positioned company with good returns."

Apart from the biggest oil companies, only two U.S. companies still operate both refineries and exploration and production units: Murphy Oil Corp and Hess.

Murphy has announced plans to sell its three refineries to intensify its focus on oil and gas exploration. Hess has interests in a refinery in the U.S. Virgin Islands and a plant in New Jersey.

On the exploration side, where analysts said Marathon has strong oil-producing assets, the company will benefit from continued high prices.

Crude oil traded in New York has not fallen below $90 per barrel in about five months, boosted by unrest in North Africa and the Middle East. Recovering world economies have also boosted demand for fuel. That scenario has left many analysts and companies forecasting continued high prices for oil.

For example, ConocoPhillips, the third-largest U.S. oil company, is planning its business around a long-term crude oil price forecast of $80 to $110 per barrel, the company said earlier this month. By contrast, North American natural gas prices, burdened by huge supplies, are expected to remain depressed for quite some time.

That should benefit Marathon, since its exploration and production assets have a higher weighting toward oil than competitors and include properties in Canada's oil sands, Kurdish Iraq and the Bakken oil shale in North Dakota.

"Prior to the split, it's a company that had a nice exploration and production business that was somewhat ignored by the market," said Phil Weiss, an oil analyst at Argus Research. "It traded more like a refining company."

While Marathon's production growth may lag, its exposure to oil will generate good cash flow for the exploration and production company if prices stay high, he said.

And that scenario should pay off for the Smart Money investors who picked up shares in the first quarter.

(Editing by Aaron Pressman and John Wallace)
By Maria Aspan  
New York, June 1

The recovery of Citigroup and Bank of America provided famed hedge fund managers like Lee Ainslie and Jeff Altman some of their biggest gains last year, but now the smart money is getting out while the getting is good.

With Ainslie’s Maverick Capital, Altman’s Owl Creek Asset Management and other major funds backing away from the banking sector in the first quarter, financials suffered the biggest decrease in sector holdings among the Smart Money 30, a group of some of the largest stock-picking hedge funds.

Ainslie, Altman and Stephen Cucchiaro’s Windhaven Investment Management dumped their entire holdings in Citigroup and Bank of America during the quarter, according to data compiled by Thomson Reuters.

Eric Mindich’s Eton Park Capital, Philippe Laffont’s Coatue Capital and Andreas Halvorsen’s Viking Global Investors also rushed for the Citigroup exits.

Citigroup, the third-largest U.S. bank, was the top decrease in existing positions by the Smart Money 30.

After making a killing buying the big banks at their nadir, savvy investors are moving on. Bank stocks are still cheap, but investors expect lackluster revenue growth and new regulations to keep prices depressed for some time.

“Financials have become hated in recent months,” said Alan Villalon, a senior bank analyst at Chicago-based Nuveen Investments, which owns bank stocks.

The move to sell may be early, but it is no easy task to unwind such huge positions, even for some of the largest hedge funds.

Citigroup remained the top holding of the Smart Money funds even as they sold off almost 29 percent of their combined stake in the company in the first quarter. Bank of America and regional bank Huntington Bancshares Inc were also among the top decreases in existing positions.

Investors even shied away from stronger banks. Appaloosa manager David Tepper sold off his stakes in JPMorgan Chase & Co and Wells Fargo & Co at the same time that he dumped some of his shares of Bank of America and Citigroup. Lone Pine Capital also reduced its stake in JPMorgan Chase and Citigroup.
U.S. banks have largely recovered from the worst losses of the financial crisis. But their profits over the past year have come largely from releasing reserves they once set aside to cover bad loans.

Citigroup, Bank of America and even JPMorgan Chase all reported year-over-year declines in revenues in the first quarter as volatile trading environment hit investment banking results and loan books shrunk.

The broader economy also suffered during the quarter as political turmoil in the Middle East and the earthquake and tsunami in Japan roiled global markets.

"Banks are macro plays on the economy," said Jason Ware, a senior analyst with wealth management firm Albion Financial. "As the economy starts to hit a softer patch, those types of investments become less attractive."

To be sure, not everyone in the Smart Money 30 group was selling the big banks.

John Paulson made only small trims to his huge stakes in Citigroup and Bank of America. And Brookside Capital Investors bought into Citigroup and increased its stake in Bank of America. Glenview Capital also increased its Citigroup stake while buying into JPMorgan Chase.

Both Bank of America and Citigroup are relatively cheap compared to bank stocks in general, Ware said, calculating that both companies are trading under their tangible book value while banks in general are trading slightly above tangible book value.

Bank investors are also worried about the increased impact of regulation. The U.S. Dodd-Frank financial reform law passed last year will restrict banks' profits from a host of businesses, from trading to debit card processing.

But the industry is still awaiting a slew of rulemaking and in many instances does not yet know exactly how deeply the law will cut into revenues.

Bank of America, the country's largest bank, is particularly vulnerable to increasing regulation of the financial sector. The bank has estimated that it could lose $2 billion in annual revenues from Dodd-Frank's restrictions on debit card processing fees.

Citigroup has a relatively smaller U.S. business and less exposure to Dodd-Frank. But its international focus and dependence on growth in emerging markets means it was particularly vulnerable to global instability in the first quarter, including the Middle East upheaval.

"There's been concern about the tightening we've seen in emerging markets and debt issues in Europe. There are some questions about international growth and a bit of softening in U.S. growth," said Timothy Ghriskey, co-founder of Solaris Group, which owns Citigroup shares.

The banking sector is also facing government scrutiny beyond Dodd-Frank. Investors were reminded of that in March, when the Federal Reserve concluded a second round of bank stress tests and allowed only some of the largest U.S. banks to raise their dividends.

"They don't have control of their own destiny at this point," Ghriskey said.

Even though Citigroup and Bank of America have shed U.S. government ownership, the March dividend increases also highlighted their continuing weakness compared to stronger rivals.

JPMorgan Chase raised its dividend to 25
cents a share from 5 cents with the Fed's blessing, but the regulator rejected Bank of America's bid to boost its own payout later this year.

Citigroup had to make do with reinstating a one-penny dividend, which it could only afford after shrinking its outstanding share count with a reverse stock split. Investors have not looked kindly upon the split, which was seen as largely cosmetic; Citigroup shares have fallen about 9 percent since the reverse split took effect in early May.

"There's almost going to be a have and have-not environment -- those banks that return capital to shareholders are going to do well, those that can't, are not," said Ware.

“The interest in owning some of these names is squarely looked upon as, 'How much cash are they going to return to me as a shareholder?'” he said.

(Editing by Aaron Pressman and John Wallace)
COVER PHOTO: Customers leave a store with their purchases in Alexandria, Virginia, on Sept. 15, 2009. REUTERS/JONATHAN ERNST

CLEANING UP: Stephen Barnett sweeps the floor at a Dollar General store in Arvada, Colorado, on June 2, 2009. REUTERS/RICK WILKING

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