



Foot Locker (FL)

Updated May 24th, 2018 by Josh Arnold

Key Metrics

Current Price: \$45	5 Year CAGR Estimate: 17.5%	Quality Percentile: N/A
Fair Value Price: \$66	5 Year Growth Estimate: 6.5%	Momentum Percentile: N/A
% Fair Value: 68%	5 Year Valuation Multiple Estimate: 7.9%	Total Return Percentile: N/A
Dividend Yield: 3.1%	5 Year Price Target: \$90	Valuation Percentile: N/A

Overview & Current Events

Foot Locker was founded in 1974 as part of the FW Woolworth Company, and became independent in 1988. The company has outlived its former parent. This athletic apparel retailer now has \$7.7B in annual sales and a \$5.3B market cap. Foot Locker has 3,300+ stores in 24 countries under various brand names.

The company's most recent quarterly earnings showed FL struggling with volumes, leading to a 3.7% decrease in comparable sales. An extra week due to a calendar shift meant that total sales rose 4.6% but forex translation was responsible for most of that gain and excluding it, total sales were up just 2%. FL also continued to see a highly promotional marketplace, leading to lower gross margins, which fell 230bps YoY. Likewise, SG&A costs deleveraged by 40bps, squeezing operating margins. FL has seen ups and downs in terms of demand and pricing power and of late, it is certainly in the latter category. The company's recent results have understandably weighed on the share price of late.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$0.67	\$0.54	\$1.10	\$1.80	\$2.58	\$2.89	\$3.61	\$3.84	\$4.82	\$3.99	\$4.50	\$6.15
DPS	\$0.60	\$0.60	\$0.60	\$0.66	\$0.71	\$0.78	\$0.88	\$1.00	\$1.10	\$1.24	\$1.38	\$2.00

EPS has grown quite steadily in the past decade as FL has managed to grow its store count as well as its direct-to-consumer business. Damage done during the Great Recession was actually quite light and FL basically picked up where it left off in terms of earnings growth. It has since seen its EPS quadruple from 2010 levels, representing extraordinary growth for what is a rather mature business in a not-so-hot sector of retail.

We see EPS growth continuing at a mid-single digit rate going forward as FL should add 6.5% in EPS annually over the next five years. Management guided for flat to low single digit comparable sales for this year as well as a gradual recovery in gross margins, both of which should lead to upside for operating margins. The weak dollar should help FL as well as it is a truly global business and until the dollar enters another long term rally, FL will benefit in the low single digit range annually, as it has been recently. In addition, FL buys back a small amount of stock but improving prospects for earnings should afford it more purchasing power, should it choose to do so. Overall, the growth outlook for FL is fairly robust as management is confident it is past the recent issues with sales and in particular, margins. Higher comparable sales and revenue should help leverage operating costs down, and mid-single digit EPS growth should be achievable.

We see the dividend growing at about the same rate as earnings and in five years, we have the payout reaching \$2 per share. FL has always made the dividend a priority and we don't see that changing.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	18.4	19.6	13.7	12.1	12.6	12.3	14.0	16.9	13.4	13.0	10.0	14.6
Avg. Yld.	4.9%	5.7%	4.0%	3.0%	2.2%	2.2%	1.7%	1.5%	1.7%	2.4%	3.1%	2.2%

FL's P/E multiple has suffered greatly in the recent past as it is down to a historically low level. The current P/E multiple of 10 is much lower than its historical average in the mid-teens, and as a result, we see a significant 7.9% tailwind to total returns going forward from the higher multiple. This will lead to a lower yield over time but FL's total return prospects are bolstered meaningfully by its very low valuation at present, which has inflated the yield unsustainably.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	27.1%	30.1%	26.4%	27.0%	29.1%	31.3%	29.8%	32.0%	32.3%	33.9%	34.0%	34.5%
Debt/A	30%	33%	31%	30%	31%	29%	28%	30%	32%	29%	29%	30%
Int. Cov.	57	23	9	30	75	124	135	164	212	508	550	600
Payout	89%	111%	54%	36%	27%	28%	24%	26%	23%	31%	31%	33%
Std. Dev.	64.7%	41.3%	36.3%	31.5%	21.9%	20.2%	23.8%	21.5%	23.1%	59.6%	30.0%	34.0%

FL's quality metrics haven't moved much in the past decade with the exception of gross margins, and it has been for the better. Very recent results have seen FL having to promote and discount to move product but as stated, management is confident those days are coming to an end. We therefore see a gradual improvement in gross margins going forward, contributing to earnings growth. FL is extremely conservatively financed at less than one-third of its assets encumbered by liabilities and as a result, its diminutive interest expense is covered hundreds of times over by its earnings power. The dividend is around one-third of earnings and we see that remaining as such going forward barring a strategic shift.

Foot Locker's competitive advantage is in its valuable brand names, its decades of experience in athletic apparel retailing and its enormous scale. This affords FL the financial stability others crave during a recession but it doesn't make FL immune to such an event, and earnings will like suffer materially during the next downturn.

Final Thoughts & Recommendation

Overall we see FL as a stock with a nice current yield, moderate growth prospects and a very cheap valuation, creating an extremely attractive stock. We forecast total annual returns of 17.5%, consisting of the current 3.1% yield, 6.5% EPS growth and a 7.9% tailwind from a rising valuation. Investors have punished FL for what appear to be temporary issues and as a result, it looks favorable for growth, value and income investors alike. FL isn't without its risks but the stock appears to be pricing in those risks and then some, and we therefore see it as quite attractive here.

Total Return Breakdown by Year

