



# Kohl's Corporation (KSS)

Updated May 1<sup>st</sup>, 2018 by Josh Arnold

## Key Metrics

<b>Current Price:</b> \$62	<b>5 Year CAGR Estimate:</b> 11.1%	<b>Quality Percentile:</b> N/A
<b>Fair Value Price:</b> \$70	<b>5 Year Growth Estimate:</b> 4.6%	<b>Momentum Percentile:</b> N/A
<b>% Fair Value:</b> 88%	<b>5 Year Valuation Multiple Estimate:</b> 2.6%	<b>Total Return Percentile:</b> N/A
<b>Dividend Yield:</b> 3.9%	<b>5 Year Price Target:</b> \$88	<b>Valuation Percentile:</b> N/A

## Overview & Current Events

Kohl's was founded in 1988 and since then, has become a big competitor in the off-price home goods and apparel sector. In the past 30 years it has grown to more than 1,100 locations and should produce \$19B in revenue this year from a diverse set of product categories. The company's market cap is just over \$10B after a sizable recent rally.

The company's recent Q4 report was outstanding as comparable sales soared 6.3% following years of flat or negative results. In addition, broad-based strength brought about by much higher traffic numbers saw gross margins rise and SG&A costs fall, improving operating margins. It also worked through some of its excess inventory, creating an opportunity to free up cash and see improved margins in 2018 as its assortment should be better positioned. Overall, KSS' Q4 was quite good and it has investors believing in the company's turnaround efforts.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$2.89	\$3.23	\$3.65	\$4.30	\$4.17	\$4.05	\$4.24	\$3.46	\$3.11	\$4.19	<b>\$5.20</b>	<b>\$6.50</b>
<b>DPS</b>	N/A	N/A	N/A	\$1.00	\$1.28	\$1.40	\$1.56	\$1.80	\$2.00	\$2.20	<b>\$2.44</b>	<b>\$3.58</b>

EPS growth has been elusive for Kohl's over the past decade as it has seen strong growth in some years, only to see that growth walked back by weaker years that followed. Indeed, last year's EPS was actually below 2011's level in a harsh illustration of just how tough things have been for Kohl's. However, it certainly appears the company has turned the corner and this year should see roughly 25% growth in EPS, aided by a lower tax rate. Going forward we are forecasting EPS growth of 4.6% as Kohl's continues to see low single digit revenue growth, a small tailwind from the buyback and a diminutive but helpful tailwind from operating earnings expansion. Kohl's is well-positioned to see continued margin expansion as it downsizes its store footprint – producing occupancy cost savings – as well as working through its overbought inventory position. These efficiency measures should continue to provide a tailwind to the company's profitability and combined with revenue growth and the buyback, we should see mid-single digit growth in EPS.

We expect the sizable dividend to continue to grow in the high single digits as Kohl's certainly qualifies as an income stock, and management remains committed to keeping it that way. EPS growth will afford Kohl's the opportunity to continue to raise the payout substantially going forward without undue stress on its financials.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	14.5	15.0	14.3	11.9	11.7	12.7	13.2	17.1	14.1	10.4	<b>11.9</b>	<b>13.5</b>
<b>Avg. Yld.</b>	N/A	N/A	N/A	2.0%	2.6%	2.7%	2.8%	3.1%	4.6%	5.1%	<b>3.9%</b>	<b>4.1%</b>

The stock's P/E multiple has bounced around quite a bit in recent years but has tended to stay in the mid-teens. Currently it sits at just 11.9 and we see that as less than fair value, implying a move up to 13.5 in the coming years. The current P/E multiple is higher than the trough value set in 2017 as the recent rally in the stock has taken care of much of the undervaluation. Still, stronger-than-normal EPS growth should continue to improve investor sentiment and see the valuation higher moving forward.

The combination of a slightly higher PE multiple but quickly-growing payout should see the yield stay around 4% in the coming years. Management has shown its commitment to the dividend and that will afford investors a very strong yield.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	36.7%	35.2%	35.3%	37.4%	37.2%	36.7%	36.5%	36.1%	37.1%	35.3%	<b>35.5%</b>	<b>36.0%</b>
<b>Debt/A</b>	42%	41%	47%	40%	54%	57%	58%	58%	60%	62%	<b>62%</b>	<b>60%</b>
<b>Int. Cov.</b>	13.8	14.0	6.2	6.9	7.2	5.7	5.2	5.0	4.2	3.8	<b>4.0</b>	<b>4.2</b>
<b>Payout</b>	N/A	N/A	N/A	23%	30%	34%	37%	52%	64%	64%	<b>47%</b>	<b>55%</b>
<b>Std. Dev.</b>	53.3%	33.3%	21.5%	28.9%	25.8%	14.9%	21.3%	30.6%	40.9%	36.4%	<b>33.0%</b>	<b>30.0%</b>

Kohl's quality metrics have been neutral in recent years as its trouble with growth has disallowed any meaningful improvements. Its gross margins are finally on the rise again after years of weakness and recent trends regarding inventory, traffic and pricing bode well going forward. Its balance sheet is still very clean and a recent tender offer for \$300M in debt shows management is serious about reducing leverage where possible, which also helps improve interest coverage. The payout ratio should decline this year as strong EPS growth outpaces dividend growth but we see dividends outgrowing EPS in the next few years, pushing the payout ratio up to 55% from the current 47%.

Kohl's competitive advantage is in its enormous footprint and inventory assortment that capitalizes on the well-known appeal of off-price apparel. That doesn't mean it is immune from recession but it did perform well in 2009 at the height of the downturn.

### Final Thoughts & Recommendation

Overall, we see Kohl's as a potential buy for investors looking for retail exposure. The company's growth fundamentals have improved materially, it offers an above average yield and the stock is trading under fair value. We see total annual returns of 11.1% moving forward, consisting of the current 3.9% yield, 4.6% EPS growth and a 2.6% tailwind from the valuation drifting higher. Kohl's would therefore be appropriate for value investors, those seeking moderate growth and above all income investors. Kohl's has had a difficult time in recent years but evidence would suggest those struggles have ended for now and the stock looks compelling because of it.

### Total Return Breakdown by Year

