Ross Stores (ROST)

Updated June 5th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$83	**5 Year CAGR Estimate:**	6.6%	**Quality Percentile:**	N/A
Fair Value Price:	$66	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	N/A
% Fair Value:	126%	**5 Year Valuation Multiple Estimate:**	-4.5%	**Total Return Percentile:**	N/A
Dividend Yield:	1.1%	**5 Year Price Target**	$106	**Valuation Percentile:**	N/A

Overview & Current Events

Ross Stores operates 1,432 stores with off-price apparel and home fashion in 38 states. It also operates 219 dd's DISCOUNTS stores in 17 states. The retailer offers attractive merchandize at a 20%-60% discount compared to the regular prices of department and specialty stores.

Ross Stores has pronouncedly outperformed the market in almost any time horizon one can check. In the last 12 months, the stock has rallied 31% whereas S&P has gained 13%. The company has grown its revenue and its EPS every single year for more than a decade. This record is a testament to the strength of its business model and the quality of its management, which executes its growth plan in an exemplary way.

The key behind its exceptional record is the fact that it offers great discounts on several popular brands. It thus creates a treasure-hunting experience, which is appealing to consumers and constitutes a wide moat. This unique shopping experience helps explain why Ross Stores is one of the few retailers that have not been affected by Amazon. Moreover, while the U.S. economy has been growing for years, consumers have become increasingly price-conscious in recent years. Therefore, Ross Stores appeals to a wide range of consumers.

In Q1, the company missed the EPS estimates by a wide margin ($0.92 vs. consensus of $1.07), mostly due to increased freight costs and its wage hikes. As it was the first miss after seven consecutive beats on both lines, the stock plunged 8% on that day. However, as the market is well aware that the company has always recovered from short-term setbacks, the stock has already retrieved all its losses in the two weeks that have followed its earnings release.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$0.58	$0.89	$1.16	$1.43	$1.77	$1.94	$2.21	$2.51	$2.83	$3.34	***$4.00***	***$6.44***
DPS	$0.10	$0.12	$0.18	$0.24	$0.30	$0.36	$0.40	$0.47	$0.54	$0.64	***$0.90***	***$1.70***

Ross Stores has grown its EPS 7-fold in the last decade, from $0.48 in 2007 to $3.34 last year. Moreover, it still has great growth prospects ahead. More precisely, it currently has 1,651 stores while its management has repeatedly stated that it sees potential for 2500 stores in the U.S. As the management has kept this target constant for more than five years, the target can be considered reliable. Therefore, the company can still grow its store count by 51%. In addition, given that the retailer opens about 100 new stores per year, it is evident that it has at least another 9 years of growth ahead.

The management recently provided guidance for EPS around $4.00 for this year. Moreover, the company has grown its EPS by 21.4% and 13.5% per year on average in the last 10 and 5 years, respectively. As the retailer will find it increasingly hard to keep growing at its historical pace, it is prudent to assume 10.0% average annual EPS growth for the next five years, from $4.00 this year to $6.44 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.1	11.6	12.0	14.1	17.2	17.4	17.0	20.3	21.4	19.7	***20.8***	***16.5***
Avg. Yld.	1.2%	1.2%	1.3%	1.2%	1.0%	1.0%	1.1%	0.9%	0.9%	1.0%	***1.1%***	***1.6%***

Thanks to its strong rally in the last 12 months, Ross Stores is now trading at a P/E of 20.8, which is much higher than its 10-year average P/E of 16.5. As it is reasonable to expect the stock to revert to its average valuation level in the next five years, the stock is likely to incur a 4.5% annualized contraction of its P/E ratio during this period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	57.2%	64.9%	67.1%	68.6%	71.7%	73.8%	73.6%	66.2%	69.1%	69.6%	*70.0%*	*72.0%*
Debt/A	59.1%	57.7%	58.2%	57.2%	54.8%	51.9%	48.5%	51.4%	49.2%	48.2%	*47.0%*	*45.0%*
Int. Cov.	---	95.6	95.9	94.9	103.1	184.2	---	498.9	128.8	109.5	*118.0*	*110.0*
Payout	17.2%	13.5%	15.5%	16.8%	16.9%	18.6%	18.1%	18.7%	19.1%	19.2%	*22.5%*	*26.4%*
Std. Dev.	38.7%	28.9%	23.7%	22.4%	21.4%	19.4%	24.2%	20.4%	16.9%	25.4%	*20.0%*	*20.0%*

Ross Stores currently offers a low dividend yield (1.1%). However, it has raised its dividend at a 24% average annual rate since 2001. Moreover, it has a very low payout ratio while it also has a markedly strong balance sheet. Furthermore, its capital expenses have remained below half of its operating cash flows every year in the last decade. Thus the company has enjoyed remarkably strong free cash flows and is likely to continue to do so for the foreseeable future. As a result, Ross Stores will likely keep growing its dividend at a double-digit pace for years.

Ross Stores is also markedly resilient during recessions. As consumers become particularly price-sensitive during recessions, they rush into the stores of the company even during rough periods. This was evident in the Great Recession. While most retailers saw their earnings plunge, Ross Stores almost doubled its EPS, from $0.48 in 2007 to $0.89 in 2009.

Final Thoughts & Recommendation

Ross Stores offers a 6.6% average annual return over the next five years thanks to 10.0% annual EPS growth and its 1.1% dividend, which will be partly offset by a 4.5% annualized P/E contraction. Make no mistake, Ross is a high quality discount retailer with a wide moat and solid growth prospects over the next several years. Unfortunately, the stock is currently overvalued which prevents us from recommending it as a buy at this time.

Total Return Breakdown by Year