



# Kohl's Corporation (KSS)

Updated August 21<sup>st</sup>, 2018 by Josh Arnold

## Key Metrics

<b>Current Price:</b> \$77	<b>5 Year CAGR Estimate:</b> 6.0%	<b>Volatility Percentile:</b> 93.0%
<b>Fair Value Price:</b> \$70	<b>5 Year Growth Estimate:</b> 4.6%	<b>Momentum Percentile:</b> 98.8%
<b>% Fair Value:</b> 110%	<b>5 Year Valuation Multiple Estimate:</b> -1.8%	<b>Valuation Percentile:</b> 40.8%
<b>Dividend Yield:</b> 3.2%	<b>5 Year Price Target:</b> \$88	<b>Total Return Percentile:</b> 32.5%

## Overview & Current Events

Kohl's was founded in 1988 and since then, has become a noteworthy 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 numerous product categories. The company's market capitalization is \$13 billion after a sizable recent rally.

Kohl's reported Q2 earnings on 8/21/18 and results were very strong. Total revenue rose 4% while comparable sales were up a very respectable 3.1%. Kohl's said strength came from Men's and Women's apparel in particular, but all geographic regions and product categories were higher year-over-year. Gross margins rose 42bps while SG&A costs rose slightly more quickly than revenue, which offset gross margin gains. Still, earnings-per-share were 42% higher to \$1.76 and Kohl's boosted guidance to a range of \$4.96 to \$5.36 in earnings-per-share for this year. Our estimate of \$5.20 is therefore unchanged after what was a very nice report from the department store chain.

## 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>

Earnings-per-share 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 earnings-per-share 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 earnings, aided by a lower tax rate. Going forward we are forecasting 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 earnings; the strong Q2 report and guidance raise have reinforced this.

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. Earnings 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>14.8</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>3.2%</b>	<b>4.1%</b>

The stock's price-to-earnings multiple has bounced around quite a bit in recent years but has tended to stay in the mid-teens. Currently it sits at 14.8 and we see that as above fair value, implying a 1.8% headwind annually as the stock returns to its longer-term average of 13.5. Kohl's was under fair value at the time of our last report, but the recent rally has shares at 110% of our fair value estimate.

*Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.*

The combination of a lower price-to-earnings multiple but quickly-growing payout should see the yield near 4% in the coming years, which is a significant increase from the current 3.2% 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>

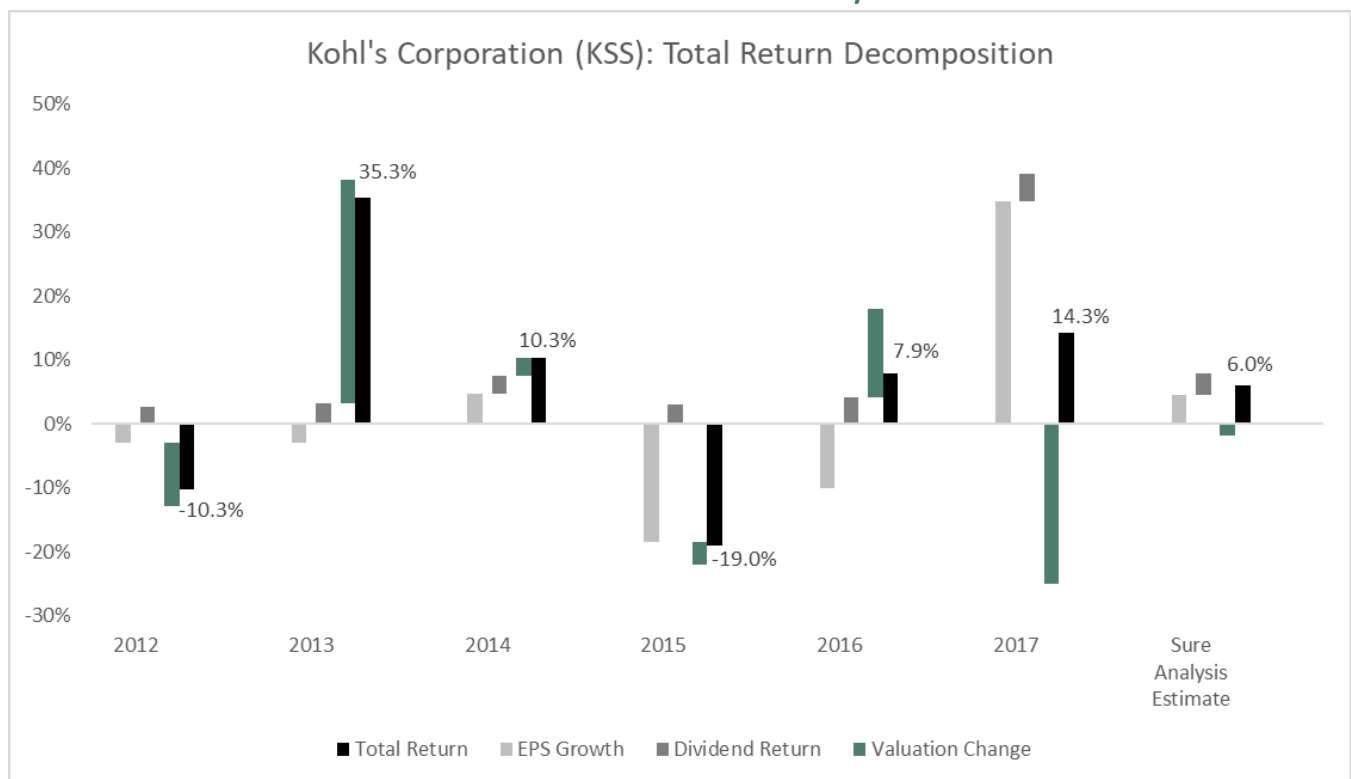
Kohl's quality metrics have been neutral in recent years as its trouble with growth has disallowed any meaningful improvements. Its gross margins are finally on the rise again after years of weakness and recent trends regarding inventory, traffic and pricing bode well going forward. Its balance sheet is still very clean and a recent tender offer for \$300 million 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 earnings growth outpaces dividend growth, but we see dividends outgrowing earnings 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 does not 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 hold. The recent rally in the stock has taken it from being relatively cheap to meaningfully in excess of fair value. We see total annual returns of 6.0% moving forward, consisting of the current 3.2% yield, 4.6% earnings growth and a 1.8% headwind from the valuation drifting higher. Kohl's still has a compelling long-term story, but the current price is too high. The stock is still yielding more than 3% so income investors may be enticed to own it, but for price appreciation, we recommend investors wait until it is closer to fair value.

## Total Return Breakdown by Year



Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.