Lowe's Companies (LOW)

Updated August 22nd, 2018 by Jonathan Weber

Key Metrics

Current Price:	$106	**5 Year CAGR Estimate:**	3.9%	**Volatility Percentile:**	61.5%
Fair Value Price:	$77	**5 Year Growth Estimate:**	8.2%	**Momentum Percentile:**	85.0%
% Fair Value:	137%	**5 Year Valuation Multiple Estimate:**	-6.1%	**Valuation Percentile:**	9.7%
Dividend Yield:	1.8%	**5 Year Price Target**	$115	**Total Return Percentile:**	18.1%

Overview & Current Events

Lowe's is the second-largest home improvement retailer in the US (after Home Depot). The company, which has a market capitalization of $87 billion, was founded in 1946 and has become a Dividend King over the decades.

Lowe's most recent quarterly results were announced on August 22. The company reported revenues of $20.9 billion, an increase of 7.1% year over year. The company also reported earnings per share of $2.07, an increase of 32% compared to the previous year's second quarter. Lowe's comparable sales performance was quite strong, as same store sales rose by 5.2% year over year. Comps sales therefore were responsible for the majority of Lowe's revenue growth.

Guidance for 2018 was updated. Lowe's now sees sales growth of 4%-5% during 2018. Earnings per share are seen at $4.50 to $4.60, which is much lower than our prior estimate of $5.45. We have updated our earnings and fair value estimates accordingly. In addition, Lowe's free cash flow guidance was increased to $5.8 billion for the current year.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.49	$1.21	$1.44	$1.69	$1.76	$2.16	$2.67	$3.29	$3.99	$4.39	***$4.55***	***$6.74***
DPS	$0.34	$0.36	$0.42	$0.53	$0.62	$0.70	$0.87	$1.07	$1.33	$1.58	***$1.78***	***$2.62***
S/O	1470M	1459M	1354M	1241M	1110M	1030M	960M	910M	866M	830M	***795M***	***670M***

Lowe's is not opening a lot of new stores, but the company still managed to grow its profits at a very attractive pace in the past. This is due to several factors, including a strong comparable store sales performance, which lifts revenues as well as margins.

Earnings per share were further driven by the company's share repurchases, which have lowered the share count meaningfully. This means that the company's net earnings are split over a lower number of shares, which accelerates growth in per-share net income. Especially when Lowe's valuation was lower during the last couple of years these share repurchases were highly accretive. Lowe's would likely ramp up its buybacks if its valuation declined meaningfully.

Lowe's is a Dividend King - the company has raised the dividend annually for more than 50 years in a row - and its dividend growth rate has very high recently. Lowe's has raised its dividend by 21% per year over the last 5 years.

Since the housing market and the economy are doing well, and since consumers have a lot of disposable income, Lowe's should be able to perform well over the foreseeable future. Further sizeable earnings increases seem very likely.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.1	16.8	16.1	14.1	17.3	20.4	19.8	21.8	18.6	18.7	***23.3***	***17.0***
Avg. Yld.	1.5%	1.7%	1.8%	2.2%	2.0%	1.6%	1.6%	1.5%	1.8%	1.9%	***1.8%***	***1.9%***

Shares of Lowe's are trading at a high valuation right now, both relative to how shares were valued in the past as well as on an absolute basis. This is due to a combination of a share price that has risen a lot over the last couple of weeks. At the same time, one-time items due to the closing of Lowe's Orchard Supply Hardware store in 2018 will pressure profits. The combination of these two factors has made Lowe's PE ratio rise to the highest level over the last couple of years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	50.6%	50.1%	51.0%	51.8%	52.9%	56.6%	61.8%	65.8%	65.4%	66.3%	***68.0%***	***70.0%***
Debt/A	44.7%	42.1%	46.3%	50.6%	57.5%	63.9%	68.8%	75.4%	81.4%	83.3%	***85.0%***	***85.0%***
Int. Cov.	13.6	10.9	10.8	8.9	8.5	8.8	9.3	9.0	9.1	10.4	***12.0***	***12.0***
Payout	22.8%	29.7%	29.2%	31.4%	35.2%	32.4%	32.6%	32.5%	33.3%	36.0%	***39.1%***	***38.9%***
Std. Dev.	57.7%	40.8%	27.5%	29.0%	27.4%	23.0%	18.9%	20.6%	21.1%	21.9%	***16.0%***	***15.0%***

Gross profits as a percentage of total assets have been rising steadily. This is a positive and can be explained by the rising comparable store sales, which lead to higher gross profits, with the asset base not changing much, since Lowe's is not opening many new stores. Debt relative to all assets has been increasing steadily, as Lowe's has taken on significant amounts of new debt. Interest coverage remains high and has actually been increasing over the last five years.

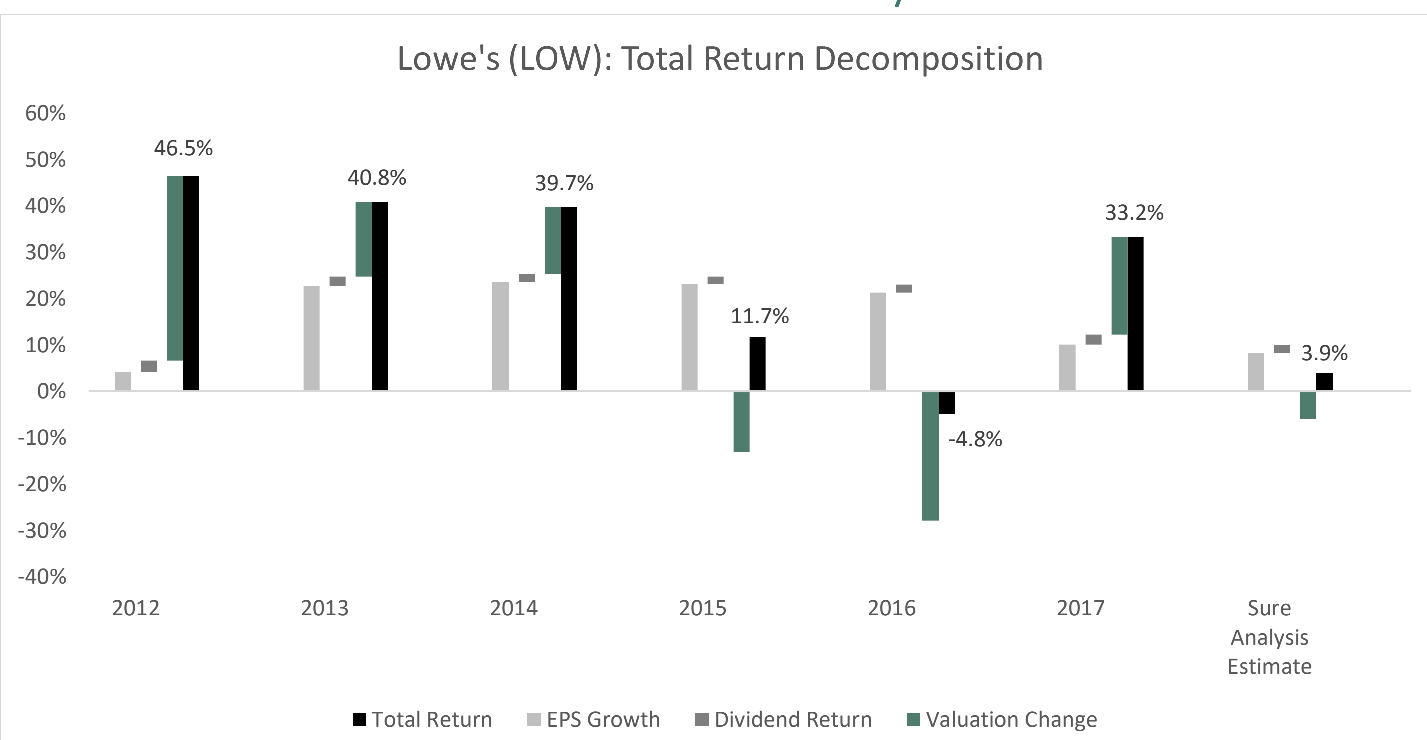
Lowe's business is somewhat cyclical, but the company performed well during the last financial crisis. Earnings declined by less than 20%, despite the housing market hit. Lowe's is operating in a duopoly with Home Depot. Neither of the two are expanding their store count significantly and neither is interested in a price war. Both should remain highly profitable, as the home improvement market in the US is large enough for two companies to make a lot of money.

Due to the low payout ratio the dividend looks very safe, and as earnings will continue to rise at an attractive pace, the dividend will likely continue to increase meaningfully going forward.

Final Thoughts & Recommendation

Lowe's is active in an attractive market and has a great track record of growing its profits as well as its dividends over decades. The macro environment is attractive, and Lowe's will be able to grow its comps sales at a meaningful pace. The company will be impacted by charges due to the closing of its Orchard Supply Hardware stores in 2018, though, which will lead to low earnings growth this year. Due to a high valuation, total returns from the current level will most likely be very poor. Because of this, Lowe's earns a sell recommendation from Sure Dividend at current prices. At or below fair value, Lowe's would be worthy of a closer look for dividend growth investors as well as for those seeking total returns.

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.