Macy's (M)

Updated August 15th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$35	**5 Year CAGR Estimate:**	11.0%	**Volatility Percentile:**	94.9%
Fair Value Price:	$43	**5 Year Growth Estimate:**	2.6%	**Momentum Percentile:**	98.8%
% Fair Value:	82%	**5 Year Valuation Multiple Estimate:**	4.1%	**Valuation Percentile:**	89.6%
Dividend Yield:	4.3%	**5 Year Price Target**	$48	**Total Return Percentile:**	71.4%

Overview & Current Events

Macy's is a department store company that operates brick and mortar stores as well as online stores under the Macy's, Bloomingdale's and Bluemercury brands. Macy's was founded in 1929, is headquartered in Cincinnati, Ohio, and currently has a market cap of $11 billion.

Macy's reported its most recent quarterly results on August 15. The company grossed revenues of $5.6 billion during Q2, 1% less than during the previous year's quarter. The sales decline was based on store closings. On a per-store level comparable sales were up by 0.5%. Macy's earned $0.59 per share during the second quarter, a major increase versus the $0.37 per share that Macy's earned during Q2 of 2017. Macy's increased its earnings per share guidance to $3.95 to $4.15 for the current fiscal year. The market nevertheless reacted negatively to Macy's results, sending shares lower by 16%. Shares are still up by 40% year to date, though.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.29	$1.41	$2.03	$2.88	$3.45	$4.00	$4.40	$3.77	$3.13	$3.77	***$4.05***	***$4.61***
DPS	$0.35	$0.20	$0.20	$0.35	$0.70	$0.90	$1.13	$1.35	$1.48	$1.50	***$1.50***	***$1.65***

Macy's earnings-per-share grew every year coming out of the Great Recession up to 2014. After earnings-per-share peaked in 2014 they declined considerably, though, which is primarily due to the struggles the brick-and-mortar retail industry has seen since. Online competition from companies such as Amazon has made many retailers struggle to generate rising comparable store sales, especially those whose business is easily impacted by online competition. Groceries, home improvement retailers, etc. are less affected than clothing retailers, for example.

This has led to earnings declines for department stores such as Macy's, but more recently things are pointing upwards again. During the first half of 2018 Macy's grew its profits considerably, and the company is making strategic moves to stabilize its business. Macy's is expanding its own online business and moving towards an omni-channel approach, coupling online and brick-and-mortar sales. Macy's has been successful in this approach (compared to other brick-and-mortar focused retailers), which is one of the reasons why Macy's comps sales kept rising in the recent past.

With the economy doing well and disposable incomes rising significantly Macy's also benefits from a macro tailwind going forward, as this should push sales up for most retailers. Macy's has stated that it will continue to close down the least profitable stores to focus on the most profitable locations, which will help increase margins going forward. At the same time the sale of less profitable assets produces additional cash flows that Macy's is currently using to reduce its debt, which, in turn, is also beneficial for its earnings due to lower interest expenses.

Macy's should be able to produce at least low-single-digits earnings per share growth over the next couple of years. The company has not increased its dividend in a while, as Macy's is focused on bringing down debt levels right now.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	13.9	9.9	10.7	9.7	11.1	11.7	13.4	15.2	11.9	6.6	***8.6***	***10.5***
Avg. Yld.	2.9%	1.4%	0.9%	1.3%	1.8%	1.9%	1.9%	2.4%	4.0%	6.1%	***4.3%***	***4.1%***

Macy's shares are valued at a quite inexpensive valuation right here, as they trade at less than 9 times this year's earnings. This represents a sizeable discount to the long-term median earnings multiple.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	44.6%	44.7%	49.3%	48.3%	53.1%	51.9%	52.7%	51.4%	51.2%	49.9%	***50.0%***	***50.0%***
Debt/A	78.8%	77.9%	73.3%	73.2%	70.9%	71.3%	75.1%	79.1%	77.9%	70.6%	***68.0%***	***61.0%***
Int. Cov.	-	1.9	3.3	5.5	4.8	6.9	6.8	5.7	3.6	6.1	***6.5***	***7.0***
Payout	27.3%	14.2%	9.9%	12.2%	20.3%	22.5%	25.7%	35.8%	47.3%	40.1%	***37.0%***	***35.8%***
Std. Dev.	70.2%	36.8%	32.1%	23.4%	21.3%	17.4%	28.4%	38.3%	47.1%	45.6%	***36.0%***	***32.0%***

Macy's produces a high amount of gross profits relative to the assets it owns, which is, at least partially, due to the fact that its assets are significantly depreciated on its balance sheet.

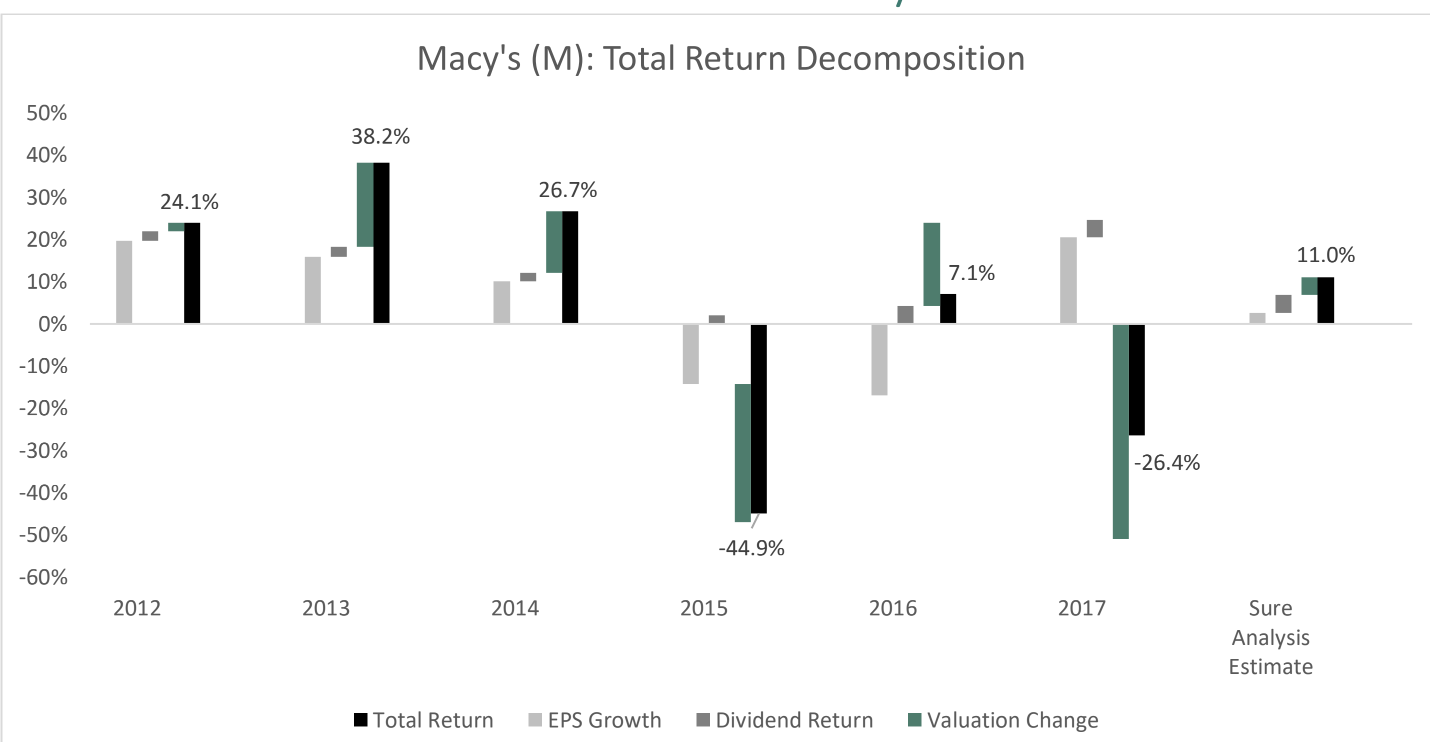
Debt to assets are at a relatively high level, but Macy's has started reducing its debt in 2016 and has made a lot of progress in this regard during 2017 and 2018. Since Macy's produces high cash flows, and only pays out ~$460 million in dividends each year, Macy's has a lot of surplus cash flows that can be used for share repurchases or debt reduction.

Macy's has a renowned brand, and 50% of Americans shop at Macy's at least once a year. There is a Macy's store in the majority of grade A malls, and macys.com gets more than 1.5 billion visits annually. This shows that Macy's has a strong position in the brick-and-mortar department store industry. Competitors therefore will have a hard time taking market share from Macy's. Online competition is another issue, but Macy's own e-commerce presence and omni-channel strategy should help soften the impact Amazon and others will have on Macy's going forward. From 2007 to 2009 Macy's earnings declined by 35%, but the company remained highly profitable and cash flow positive.

Final Thoughts & Recommendation

Macy's turnaround is seemingly on track, the company delivered solid results during H1 and the outlook is positive as well. Macy's should deliver compelling total returns over the coming years, and due to a high dividend yield Macy's looks like a potential buy for income investors. As with all brick-and-mortar retailers there are some risks, though.

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.