# Ross Stores (ROST)

*Updated August 24th, 2018 by Aristofanis Papadatos*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $90 | **5 Year CAGR Estimate:** | 5.3% | **Volatility Percentile:** | 45.3% |
| **Fair Value Price:** | $67 | **5 Year Growth Estimate:** | 10.0% | **Momentum Percentile:** | 95.2% |
| **% Fair Value:** | 134% | **5 Year Valuation Multiple Estimate:** | -5.7% | **Valuation Percentile:** | 8.0% |
| **Dividend Yield:** | 1.0% | **5 Year Price Target** | $108 | **Total Return Percentile:** | 22.1% |

## Overview & Current Events

Ross Stores operates 1,453 stores with off-price apparel and home fashion in 38 states. It also operates 227 dd's DISCOUNTS stores in 18 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 61% whereas S&P has gained 15%. The company has grown its revenue and its earnings per share 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 almost a decade, consumers have become increasingly price-conscious in recent years. Therefore, Ross Stores appeals to a wide range of consumers.

Ross Stores reported its financial results for the second quarter of fiscal 2018 yesterday. The retailer grew its sales by 9% thanks to its new stores and 5% same-store sales growth. Earnings per share rose 27%, from $0.82 last year to $1.04. However, the operating margin fell to 13.8% due to unfavorable timing of packaway-related expenses, higher freight costs and wages. Consequently, the pre-tax earnings rose only 1%. In other words, the earnings-per-share growth resulted fully from a reduced tax rate. In the first half of the year, pre-tax earnings have grown only 5%. Moreover, management provided guidance $4.01-$4.10 for the earnings per share of this year, slightly below the $4.08 consensus.

## 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 | ***$4.07*** | ***$6.55*** |
| **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 earnings per share 7-fold in the last decade, from $0.48 in 2007 to $3.34 last year. Moreover, it still has great growth prospects ahead. It currently has 1,651 stores while its management just raised its estimate from a potential for 2500 stores to 3000 stores in the U.S. Thus the company can still grow its store count by 79%. In addition, as the retailer opens about 100 new stores per year, it is evident that it has more than a decade of growth ahead.

As Ross Stores tends to be somewhat conservative in its guidance, we have raised our earnings-per-share estimate for this year towards the upper limit of its guidance. Moreover, the company has grown its earnings per share 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, we assume 10.0% average annual earnings-per-share growth for the next five years.

## 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 | ***22.1*** | ***16.5*** |
| **Avg. Yld.** | 1.2% | 1.2% | 1.3% | 1.2% | 1.0% | 1.0% | 1.1% | 0.9% | 0.9% | 1.0% | ***1.0%*** | ***1.6%*** |

*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.*

Thanks to its 61% rally since last summer, Ross Stores is now trading at a P/E of 22.1, 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 5.7% 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% | ***46.6%*** | ***45.0%*** |
| **Int. Cov.** | --- | 95.6 | 95.9 | 94.9 | 103.1 | 184.2 | --- | 498.9 | 128.8 | 109.5 | ***500.0*** | ***500.0*** |
| **Payout** | 17.2% | 13.5% | 15.5% | 16.8% | 16.9% | 18.6% | 18.1% | 18.7% | 19.1% | 19.2% | ***22.1%*** | ***26.0%*** |
| **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%*** |

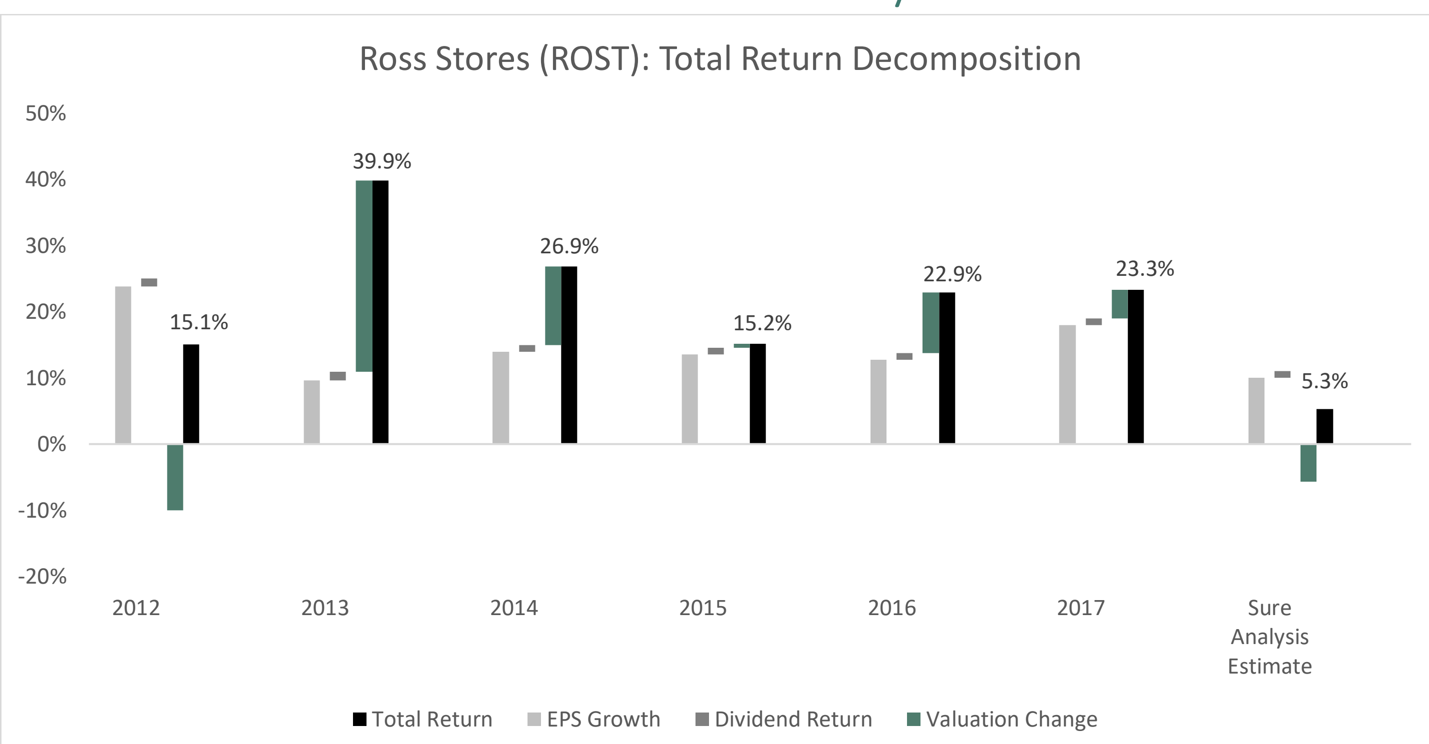
Ross Stores currently offers a low dividend yield (1.0%) but has raised its dividend at a 24% average annual rate since 2001. Moreover, it has a very low payout ratio and a markedly strong balance sheet. Furthermore, its capital expenses have remained below half of its operating cash flows every year in the last decade, thus resulting in excessive free cash flows. As a result, Ross Stores will likely keep growing its dividend at a double-digit pace for years.

Ross Stores is also resilient during recessions. As consumers become particularly price-sensitive in 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 earnings per share, from $0.48 in 2007 to $0.89 in 2009.

## Final Thoughts & Recommendation

Ross Stores offers a 5.3% average annual return over the next five years thanks to 10.0% annual EPS growth and its 1.0% dividend, which will be partly offset by a 5.7% annualized P/E contraction. Ross is a high quality discount retailer with a wide moat and solid growth prospects over the next several years. However, due to its 61% rally since last summer, the stock is currently overvalued and thus we do not recommend it as a buy at this time. On the other hand, traders may attempt to make a quick 5% profit from the stock, as it usually retrieves its post-earnings losses within a short period.

## Total Return Breakdown by Year

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