



Foot Locker (FL)

Updated November 21st, 2018 by Eli Inkrot

Key Metrics

Current Price:	\$53	5 Year CAGR Estimate:	13.5%	Volatility Percentile:	94.9%
Fair Value Price:	\$66	5 Year Growth Estimate:	6.5%	Momentum Percentile:	79.7%
% Fair Value:	81%	5 Year Valuation Multiple Estimate:	4.4%	Growth Percentile:	59.2%
Dividend Yield:	2.6%	5 Year Price Target	\$90	Valuation Percentile:	83.0%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	81.0%

Overview & Current Events

Foot Locker was established in 1974 as part of the FW Woolworth Company and became independent in 1988. The company has outlived its former parent. The athletic apparel retailer, known for its namesake Foot Locker brand, operates approximately 3,266 stores in 26 countries. Foot Locker is a \$6.1 billion market cap company on pace to generate ~\$7.7 billion in revenue and earn ~\$500 million in profits.

On November 20th, 2018 Foot Locker reported Q3 2018 results; shares opened 15% higher on the news. Third quarter comparable sales increased 2.9%, but overall sales decreased 0.5% to \$1.86 billion (hampered by a shorter time period and currency). The company's gross margin improved 60 basis points to 31.6%, leading to net income of \$1.14 per share versus \$0.81 in the year ago period. Roughly \$23 million, or \$0.19 per share, was a benefit from Tax Reform. On a non-GAAP basis Foot Locker reported earnings-per-share of \$0.95, a 9% increase compared to the \$0.87 reported a year ago.

The company's cash and equivalents totaled \$748 million against debt of \$124 million.

For the fourth quarter the company provided comparable sales guidance of low-to-mid single digit growth, a slight increase compared to previous remarks.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$0.67	\$0.54	\$1.10	\$1.80	\$2.58	\$2.89	\$3.61	\$3.84	\$4.82	\$3.99	\$4.50	\$6.17
DPS	\$0.60	\$0.60	\$0.60	\$0.66	\$0.71	\$0.78	\$0.88	\$1.00	\$1.10	\$1.24	\$1.38	\$2.00
Shares	155	157	155	152	150	146	140	137	132	120	115	105

During the last recession, Foot Locker's earnings dipped ~20%, but since then they have sharply rebounded. Indeed, from 2008 through 2017 the company has been able to increase earnings-per-share by over 20% annually. However, this was during a time when Foot Locker net profit margin improved from 2% to 6.6% and the share count was reduced by over 20% as well. Moving forward we are more cautious, albeit still optimistic, on the firm's growth prospects.

Just to give you an idea of this caution, for the first three quarters of this year Foot Locker's income before taxes was actually down 1.6%. Yet on a per share basis it is up 28.6% as the company paid significantly less in taxes and materially reduced the share count. While we believe share repurchases will continue, we do not believe margins will expand anywhere near what was accomplished in the last decade.

Meanwhile, the dividend remains as an important component due to its propensity to grow over time. While the current yield is reasonable, income investors stand to collect meaningfully higher payouts if earnings continue to grow.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	18.4	19.6	13.7	12.1	12.6	12.3	14.0	16.9	13.4	13.0	11.8	14.6
Avg. Yld.	4.9%	5.7%	4.0%	3.0%	2.2%	2.2%	1.7%	1.5%	1.7%	2.4%	2.6%	2.2%

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Despite the 15% share price increase after Foot Locker reported earnings, shares are still trading hands at less than 12 times earnings. We believe something closer to the company's historical average – 14.6 over the past decade – is much more reasonable, especially given the company's financial position and growth prospects. This implies solid upside from this point. The dividend continues to chug along and has the potential to grow at a faster rate than earnings due to the lower payout ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Payout	89%	111%	54%	36%	27%	28%	24%	26%	23%	31%	31%	32%

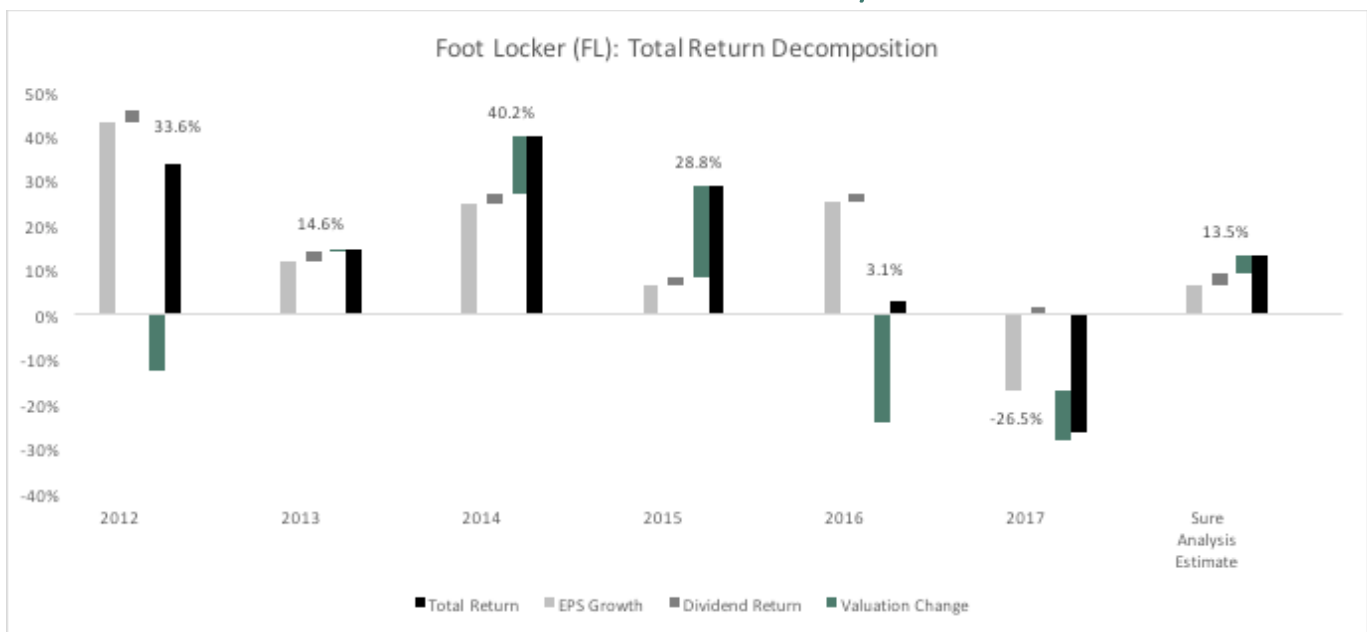
Foot Locker's competitive advantage is in its valuable brand names, its decades of experience in athletic apparel retailing and its enormous scale. Moreover, Foot Locker's balance sheet affords the company financial stability that others crave during a recession. As of the last quarterly report, the company held \$748 million in cash against \$124 million in debt and current assets alone (ignoring property and other assets) outpaced all liabilities by \$1 billion. This does not mean that earnings power will not deteriorate in lesser times (this happened last time), but it does mean that Foot Locker can withstand the tough times.

The company's payout ratio, standing at less than a third of earnings, is easily manageable and sets up well for faster dividend growth, a robust share repurchase program or both in the years to come.

Final Thoughts & Recommendation

Shares of Foot Locker are up ~10% since our last update, while our estimates for the business are basically unchanged. In this way, we are slightly less enthused today about the security than we were a couple of months ago. However, this does not mean that today's valuation does not look compelling. Foot Locker has positive traits abound, with a reasonable expectation of growth, a solid and growing dividend, a below average valuation and a strong balance sheet to provide ballast in lesser times. We rate Foot Locker as a buy at current prices.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	5237	4854	5049	5623	6182	6505	7151	7412	7766	7782
Gross Profit	1460	1332	1516	1796	2034	2133	2374	2505	2636	2456
Gross Margin	27.9%	27.4%	30.0%	31.9%	32.9%	32.8%	33.2%	33.8%	33.9%	31.6%
SG&A Exp.	1174	1099	1138	1244	1294	1334	1426	1415	1472	1501
D&A Exp.	130	112	106	110	118	133	139	148	158	173
Operating Profit	156	121	272	442	622	666	809	942	1006	782
Operating Margin	3.0%	2.5%	5.4%	7.9%	10.1%	10.2%	11.3%	12.7%	13.0%	10.0%
Net Profit	-80	48	169	278	397	429	520	541	664	284
Net Margin	-1.5%	1.0%	3.3%	4.9%	6.4%	6.6%	7.3%	7.3%	8.6%	3.6%
Free Cash Flow	237	257	229	345	253	324	522	563	578	539
Income Tax	-21	26	88	157	210	234	289	296	340	294

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	2877	2816	2896	3050	3367	3487	3577	3775	3840	3961
Cash & Equivalents	385	582	696	851	880	858	967	1021	1046	849
Accounts Receivable	53		41	49	68	99	78	94	101	106
Inventories	1120	1037	1059	1069	1167	1220	1250	1285	1307	1278
Goodwill & Int. Ass.	257	244	217	198	185	230	206	201	197	206
Total Liabilities	953	868	871	940	990	991	1081	1222	1130	1442
Accounts Payable	187	215	223	240	298	263	301	279	249	258
Long-Term Debt	142	138	137	135	133	136	132	129	127	125
Shareholder's Equity	1924	1948	2025	2110	2377	2496	2496	2553	2710	2519
D/E Ratio	0.07	0.07	0.07	0.06	0.06	0.05	0.05	0.05	0.05	0.05

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	-2.6%	1.7%	5.9%	9.4%	12.4%	12.5%	14.7%	14.7%	17.4%	7.3%
Return on Equity	-3.8%	2.5%	8.5%	13.4%	17.7%	17.6%	20.8%	21.4%	25.2%	10.9%
ROIC	-3.5%	2.3%	8.0%	12.6%	16.7%	16.7%	19.8%	20.4%	24.1%	10.4%
Shares Out.	155	157	155	152	150	146	140	137	132	120
Revenue/Share	34.01	31.06	32.22	36.42	40.14	43.22	48.98	52.64	57.48	60.84
FCF/Share	1.54	1.64	1.46	2.23	1.64	2.15	3.58	4.00	4.28	4.21

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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