Ross Stores (ROST)

Updated November 23rd, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$82	**5 Year CAGR Estimate:**	7.3%	**Volatility Percentile:**	41.1%
Fair Value Price:	$68	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	74.4%
% Fair Value:	121%	**5 Year Valuation Multiple Estimate:**	-3.8%	**Growth Percentile:**	88.7%
Dividend Yield:	1.1%	**5 Year Price Target**	$109	**Valuation Percentile:**	21.3%
Dividend Risk Score:	A	**Retirement Suitability Score:**	D	**Total Return Percentile:**	37.2%

Overview & Current Events

Ross Stores operates 1,483 stores with off-price apparel and home fashion in 38 states. It also operates 237 dd's DISCOUNTS stores in 18 states. The retailer offers attractive merchandize at a 20%-60% discounts compared to the regular prices of department and specialty stores.

Ross Stores 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 that it offers great discounts on popular brands. It thus creates a treasure-hunting experience, which is appealing to consumers and constitutes a 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.

In mid-November, Ross Stores reported (11/20/18) its financial results for the third quarter of fiscal 2018. The report was very similar to the previous one. The retailer grew its sales by 7% thanks to its new stores and 3% same-store sales growth. Earnings-per-share rose 26%, from $0.72 last year to $0.91. However, operating margin fell to 12.4% due to wage hikes and higher freight costs. Consequently, pre-tax earnings rose only 1%. In other words, earnings-per-share growth resulted almost fully from a reduced tax rate. In the first nine months of the year, pre-tax earnings have grown only 3%. Moreover, management provided guidance for the adjusted earnings-per-share of the running quarter between $1.02-$1.07, lower than the $1.08 consensus. As a result, the stock plunged 10% on its earnings release.

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	***$4.10***	***$6.60***
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***
Shares	509.4	491.7	472.3	451.8	440.0	426.8	414.9	402.3	391.9	379.6	***369.0***	***325.0***

Ross Stores has grown its earnings per share 7-fold in the last decade, from $0.48 in 2007 to $3.34 last year. And, it still has growth prospects ahead. It currently has 1,720 stores while its management is confident for a potential of 2500 stores to 3000 stores in the U.S. Thus the company can still grow its store count by 74%. As the retailer opens about 100 new stores per year, it is evident that it has at least a decade of growth ahead.

As Ross Stores tends to be somewhat conservative in its guidance, we have slightly raised our earnings-per-share estimate for this year, from $4.07 to $4.10. 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. We have also noted a change in management's language in recent quarters, as it has stated that its results have a very tough comparison base due to strong performance in recent years. This is probably a signal that management finds it increasingly hard to maintain recent growth rates.

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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	***20.0***	***16.5***
Avg. Yld.	1.2%	1.2%	1.3%	1.2%	1.0%	1.0%	1.1%	0.9%	0.9%	1.0%	***1.1%***	***1.6%***

In our last research report, in August, we stated that Ross Stores was overvalued. The stock has lost 9% since then so it is much more reasonably valued now. Nevertheless, it is still trading at a price-to-earnings ratio of 20.0, which is higher than its 10-year average price-to-earnings ratio of 16.5. If the stock reverts to its average valuation level in the next five years, it will incur a 3.8% annualized drag due to the contraction of its valuation level during this period.

Safety, Quality, Competitive Advantage, & Recession Resiliency

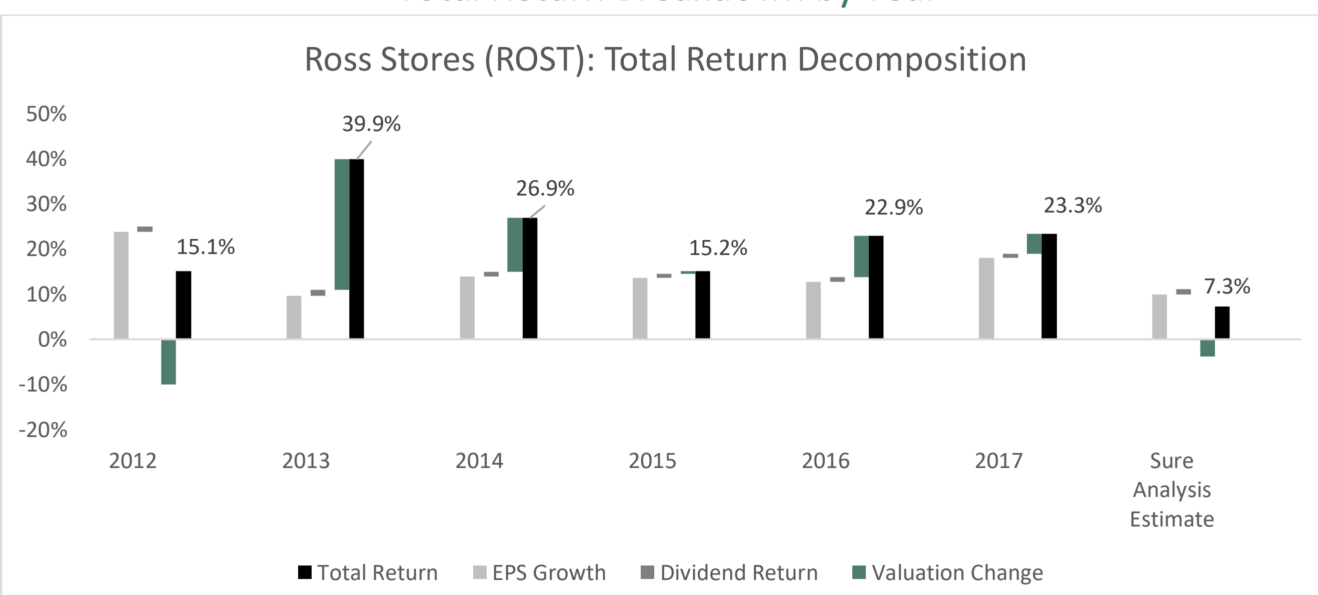
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
Payout	17.2%	13.5%	15.5%	16.8%	16.9%	18.6%	18.1%	18.7%	19.1%	19.2%	***22.0%***	***25.8%***

Ross Stores offers a low dividend yield (1.1%) but has raised its dividend at a 24% average annual rate since 2001. It also has a low payout ratio and a strong balance sheet. Furthermore, its capital expenses have remained below half of its operating cash flows every year in the last decade, resulting in high free cash flows. 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 go to the stores of the company even during rough periods.

Final Thoughts & Recommendation

In our last research report, we mentioned that Ross Stores was overvalued. The company has corrected 9% since our last report. Nevertheless, it still has a somewhat rich valuation and is likely to offer just a 7.3% average annual return over the next five years. Ross is a high quality discount retailer with a wide moat and solid growth prospects over the next several years. However, due to its rich valuation, the stock is extremely sensitive to any negative news. That's why it plunged 10% after its mild downward revision of its guidance. The stock fails to earn a buy rating, though it is a suitable hold for those who can maintain a long-term horizon and stomach short-term valuation pressure.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue	6486	7184	7866	8608	9721	10230	11042	11940	12867	14135
Gross Profit	1530	1857	2136	2368	2710	2869	3104	3363	3693	4092
Gross Margin	23.6%	25.8%	27.2%	27.5%	27.9%	28.0%	28.1%	28.2%	28.7%	29.0%
SG&A Exp.	1034	1131	1230	1304	1438	1526	1615	1739	1890	2044
D&A Exp.	142	159	161	160	185	206	233	275	303	313
Operating Profit	495	726	907	1063	1272	1343	1488	1624	1803	2048
Operating Margin	7.6%	10.1%	11.5%	12.4%	13.1%	13.1%	13.5%	13.6%	14.0%	14.5%
Net Profit	305	443	555	657	787	837	925	1021	1118	1363
Net Margin	4.7%	6.2%	7.1%	7.6%	8.1%	8.2%	8.4%	8.5%	8.7%	9.6%
Free Cash Flow	359	730	474	404	555	471	726	959	1261	1310
Income Tax	190	276	342	396	478	506	561	591	669	678

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	2356	2769	3116	3301	3671	3897	4687	4869	5309	5722
Cash & Equivalents	321	768	834	650	647	423	697	762	1112	1290
Accounts Receivable	41	44	45	51	60	63	73	74	75	88
Inventories	881	872	1087	1130	1209	1257	1373	1419	1513	1642
Total Liabilities	1359	1611	1784	1808	1904	1889	2408	2397	2561	2673
Accounts Payable	537	658	767	762	808	779	1001	946	1022	1060
Long-Term Debt	150	150	150	150	150	150	396	396	396	397
Shareholder's Equity	996	1157	1333	1493	1767	2007	2279	2472	2748	3049
D/E Ratio	0.15	0.13	0.11	0.10	0.08	0.07	0.17	0.16	0.14	0.13

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	12.9%	17.3%	18.9%	20.5%	22.6%	22.1%	21.5%	21.4%	22.0%	24.7%
Return on Equity	31.1%	41.1%	44.6%	46.5%	48.3%	44.4%	43.1%	43.0%	42.8%	47.0%
ROIC	26.9%	36.1%	39.8%	42.0%	44.2%	41.1%	38.3%	36.8%	37.2%	41.4%
Shares Out.	509.4	491.7	472.3	451.8	440.0	426.8	414.9	402.3	391.9	379.6
Revenue/Share	12.35	14.37	16.40	18.72	21.82	23.70	26.41	29.38	32.58	36.78
FCF/Share	0.68	1.46	0.99	0.88	1.25	1.09	1.74	2.36	3.19	3.41

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