



Kohl's Corporation (KSS)

Updated May 23rd, 2019 by Josh Arnold

Key Metrics

Current Price:	\$53	5 Year CAGR Estimate:	12.6%	Volatility Percentile:	92.0%
Fair Value Price:	\$64	5 Year Growth Estimate:	4.0%	Momentum Percentile:	24.3%
% Fair Value:	84%	5 Year Valuation Multiple Estimate:	3.6%	Growth Percentile:	23.2%
Dividend Yield:	5.0%	5 Year Price Target	\$77	Valuation Percentile:	76.3%
Dividend Risk Score:	C	Retirement Suitability Score:	A	Total Return Percentile:	70.6%

Overview & Current Events

Wisconsin-based retailer Kohl's traces its roots back to a single store – Kohl's Department Store – in 1962. Since then it has grown into a leader in the space – offering women's, men's and children's apparel, housewares, accessories and footwear in more than 1,100 stores in 49 states. The \$8.7 billion market capitalization company should generate in excess of \$19 billion in sales this year.

Kohl's reported Q1 results on 5/21 and the report sent shares down 12% on the day. Total revenue was down 2.9% year-over-year thanks to a 3.4% decline in comparable sales, which was well under expectations. The company's CEO, Michelle Gass, commented that the company understood its merchandise missteps in Q1 and had already taken action to remedy the problems for the back half of the year. That implies Q2 may be weak as well, but Q1 certainly was a disappointment on the top line.

Margins, predictably, suffered as well in Q1. Gross margins were essentially flat, ceding just 10bps in Q1 to 36.8%. However, SG&A costs rose 130bps as a percentage of revenue, coming in at 31.2% in Q1. That means that adjusted operating income fell from 7.0% of revenue in last year's Q1 to just 5.6% in this quarter, meaningfully crimping profitability.

The company's share count fell from 167 million to 162 million year-over-year thanks to its robust share repurchase program, which helped limit the damage to earnings-per-share. That number fell from \$0.45 to \$0.38 on a fully-diluted basis in Q1 due to weak sales and margins.

Guidance was also slashed from a prior range of \$5.80 to \$6.15 to a new range of \$5.15 to \$5.45. This has caused us to cut our estimates as well from \$5.98 to just \$5.30 for this year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$3.23	\$3.65	\$4.30	\$4.17	\$4.05	\$4.24	\$3.46	\$3.11	\$4.19	\$5.60	\$5.30	\$6.45
DPS	---	---	\$1.00	\$1.28	\$1.40	\$1.56	\$1.80	\$2.00	\$2.20	\$2.44	\$2.68	\$3.28
Shares	307	291	247	222	211	201	186	174	168	165	160	150

From 2007 through 2018, Kohl's was able to grow earnings-per-share by about 4.7% annually. However, it should be noted that this was driven by the company's extensive share repurchase program. Over that time period the share count was nearly halved, a reduction rate of 5.6% per annum. On a dollar basis, net profits are actually down (\$927 million in 2018 versus \$1.05 billion in 2007). After a sizable uptick in earnings in 2018 (in large part due to a lower tax rate), Kohl's is set for a mid-single digit decline in earnings-per-share this year. Thereafter we are more cautious with our growth rate assumption as the share repurchase program becomes more difficult with a much higher dividend payout ratio, along with the idea of a steady total store count and pressured margins.

A dividend was initiated in 2011 and since that time has become a substantial part of the capital allocation plan. This reduces the company's opportunity to retire meaningful blocks of stock, but does offer a reliable and sizable income stream for dividend investors.

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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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	15.0	14.3	11.9	11.7	12.7	13.2	17.1	14.1	10.4	11.9	10.1	12.0
Avg. Yld.	---	---	2.0%	2.6%	2.7%	2.8%	3.1%	4.6%	5.1%	3.7%	5.0%	4.2%

Over the past decade shares of Kohl's have routinely traded hands with an average multiple of about 13 times earnings. We believe that this is more or less fair, given the company's past record. However, given the enormous cut to guidance and weak Q1 results, we believe investors will be less willing to pay 13 times earnings or more in the near-term, and have cut our estimate of fair value to 12 times earnings from 13. In addition, the yield is near a decade-high at 5%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	---	23%	30%	34%	37%	52%	64%	64%	44%	51%	51%

In the table above you can see the payout ratio story playing out. Just nine years ago the dividend was non-existent. Now it makes up half of anticipated profits. Will believe this payout is well covered, but in our estimation the pace of dividend increases should slow dramatically.

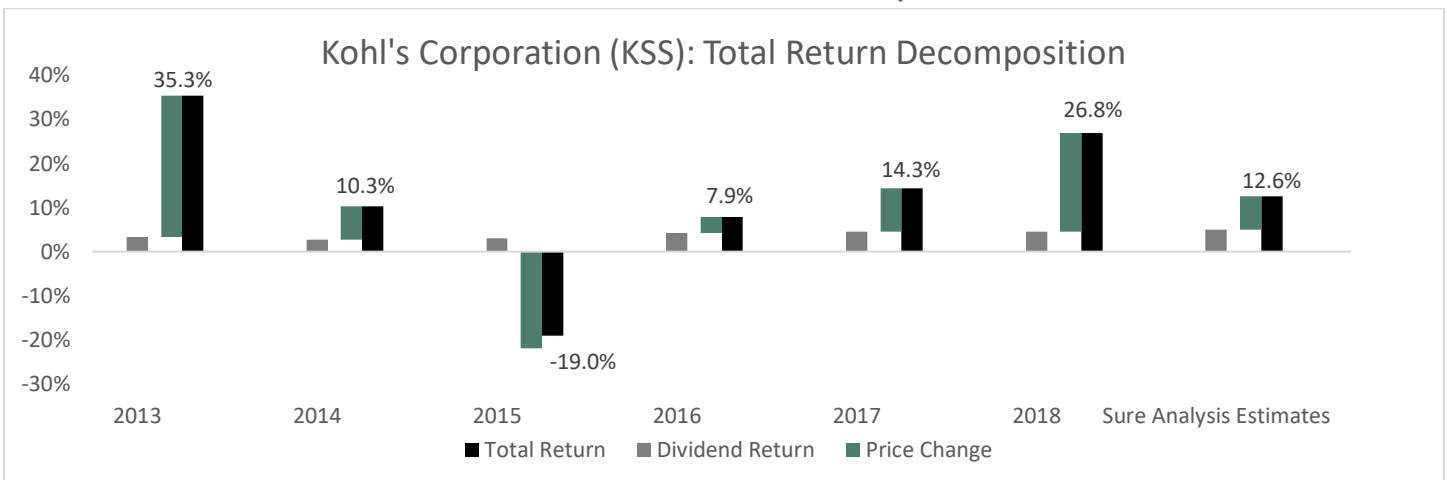
Compared to other retailers we believe Kohl's has a competitive advantage in the way of a well-entrenched store footprint outside of large malls, private-label brands, a large loyalty program, and an Amazon return service that could drive traffic. This is offset somewhat by the competitive nature of the business but it still allows Kohl's to stand out.

During the last recession Kohl's held up quite well, with earnings-per-share of \$3.39, \$2.89 and \$3.23 during the 2007 through 2009 period – representing a decline of just 15% when competitors were faring much worse. Additionally, we are encouraged by management's commitment to extinguish debt early, which ought to bode well for interest coverage.

Final Thoughts & Recommendation

Kohl's has had a rough time since our last update, and we now see shares as quite undervalued. We also see Kohl's yield as very attractive, but we note that the near-term ride may be bumpy for shareholders given the guidance cut. In total, we expect 12.6% annual returns for shareholders consisting of the 4% growth rate, 5% yield, and 3.6% tailwind from a rising valuation. Given this, we are upgrading Kohl's from a hold to a buy on the yield and valuation, but note that investors need a significant amount of patience to own this stock.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	17178	18391	18804	19279	19031	19023	19204	18686	19095	20229
Gross Profit	6498	7032	7179	6990	6944	6925	6939	6742	6919	8030
Gross Margin	37.8%	38.2%	38.2%	36.3%	36.5%	36.4%	36.1%	36.1%	36.2%	39.7%
SG&A Exp.	3951	4190	4243	4267	4313	4350	4452	4435	4512	5601
D&A Exp.	688	750	778	833	889	886	934	938	991	964
Operating Profit	1859	2092	2158	1890	1742	1689	1553	1369	1416	1465
Op. Margin	10.8%	11.4%	11.5%	9.8%	9.2%	8.9%	8.1%	7.3%	7.4%	7.2%
Net Profit	973	1120	1167	986	889	867	673	556	859	801
Net Margin	5.7%	6.1%	6.2%	5.1%	4.7%	4.6%	3.5%	3.0%	4.5%	4.0%
Free Cash Flow	1611	949	1212	480	1241	1342	794	1385	1019	1529
Income Tax	585	668	692	575	515	482	384	319	258	241

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	14465	13564	14148	13905	14357	14333	13606	13574	13340	12469
Cash & Equivalents	2267	2277	1205	537	971	1407	707	1074	1308	934
Inventories	2923	3036	3216	3748	3874	3814	4038	3795	3542	3475
Total Liabilities	6870	5462	7640	7857	8379	8342	8115	8397	7914	6942
Accounts Payable	1188	1138	1233	1307	1365	1511	1251	1507	1271	1187
Long-Term Debt	3940	2096	2141	2492	2792	2780	2792	2795	2797	1861
Total Equity	7595	8102	6508	6048	5978	5991	5491	5177	5426	5527
D/E Ratio	0.52	0.26	0.33	0.41	0.47	0.46	0.51	0.54	0.52	0.34

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	7.5%	8.0%	8.4%	7.0%	6.3%	6.0%	4.8%	4.1%	6.4%	6.2%
Return on Equity	13.6%	14.3%	16.0%	15.7%	14.8%	14.5%	11.7%	10.4%	16.2%	14.6%
ROIC	9.6%	10.3%	12.4%	11.5%	10.3%	9.9%	7.9%	6.8%	10.6%	10.3%
Shares Out.	307	291	247	222	211	201	186	174	168	165
Revenue/Share	56.14	60.10	69.39	81.35	86.50	93.25	98.48	104.39	113.66	122.60
FCF/Share	5.26	3.10	4.47	2.03	5.64	6.58	4.07	7.74	6.07	9.27

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

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