



Kohl's Corporation (KSS)

Updated September 1st, 2019 by Josh Arnold

Key Metrics

Current Price:	\$47	5 Year CAGR Estimate:	12.7%	Volatility Percentile:	94.9%
Fair Value Price:	\$58	5 Year Growth Estimate:	4.0%	Momentum Percentile:	5.5%
% Fair Value:	81%	5 Year Valuation Multiple Estimate:	4.3%	Growth Percentile:	27.4%
Dividend Yield:	5.7%	5 Year Price Target	\$71	Valuation Percentile:	76.3%
Dividend Risk Score:	B	Retirement Suitability Score:	A	Total Return Percentile:	75.3%

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 \$7.5 billion market capitalization company should generate about \$19 billion in sales this year.

Kohl's reported Q2 earnings on 8/20/19 and results were fairly weak, leading to another earnings-related selloff in the share price. Total revenue fell 3.1% to \$4.43 billion, driven primarily by a 2.9% decline in comparable sales. This decline in comparable sales offset a strong 3.1% gain in last year's Q2, bringing the two-year stacked comp to essentially flat.

Gross margins declined 72bps to 38.8% of revenue in Q2 as Kohl's continues to struggle a bit with assortment and inventory levels. This has been a key focus for some time with Kohl's and other department store operators as investors continue to worry there is too much capacity, which leads to pricing weakness.

SG&A costs were virtually flat on a dollar basis year-over-year, but deleveraged thanks to lower revenue. This, combined with lower gross margins, saw operating margins decline and earnings fall as well. Net income was down 15% on a dollar basis, falling from \$292 million to \$247 million, and 12% on a diluted earnings-per-share basis. Despite the decline from \$1.76 to \$1.55 year-over-year, Kohl's maintained its guidance range for this year and so have we, reiterating \$5.30 as our estimate. It should be noted that gross margin guidance was cut during the Q2 report, although only slightly, but Kohl's believes it can still hit its earnings guidance 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	\$3.26
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. We also think it could drive buying demand for the stock given the enormous yield.



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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	8.9	11.0
Avg. Yld.	---	---	2.0%	2.6%	2.7%	2.8%	3.1%	4.6%	5.1%	3.7%	5.7%	4.6%

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 cut to guidance and weak Q2 results, we believe investors may be less willing to pay 13 times earnings or more in the near-term, and have cut our estimate of fair value to 11 times earnings. We see valuations in department store stocks continuing to decline, and think investors may pay less for Kohl's over the near-term. However, the yield is at a decade-high at 5.7%, making Kohl's a top-tier income stock for those that can stomach the volatility.

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.

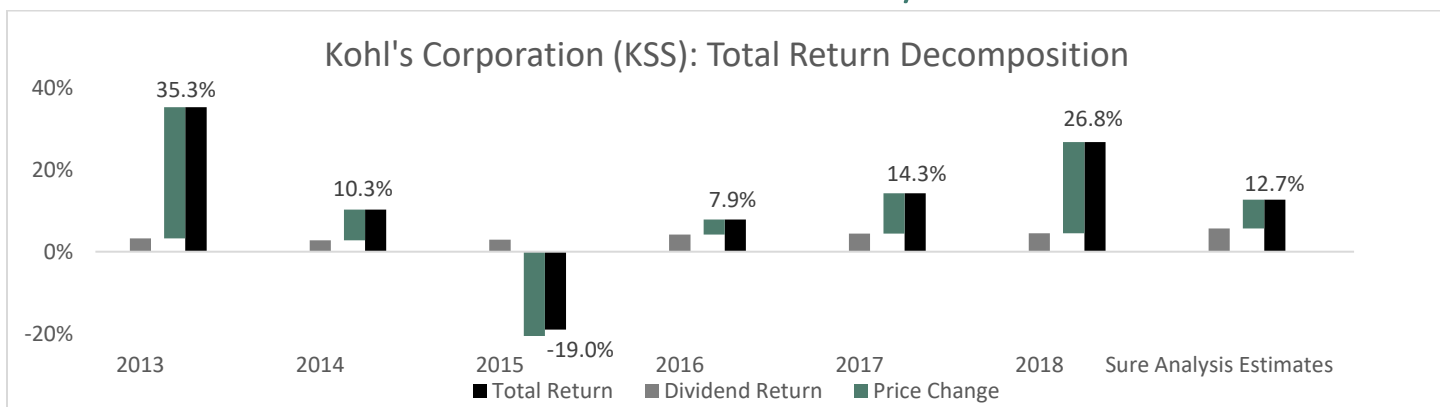
Compared to other retailers we believe Kohl's has a competitive advantage in the way of a well-entrenched store footprint outside of large malls, private-label brands, a large loyalty program, and an Amazon return service that is driving traffic. This is offset somewhat by the competitive nature of the 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 continue to 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 nearly 13% annual returns for shareholders consisting of moderate earnings growth, a 5.7% dividend yield, and sizable tailwind from a rising valuation. However, with near-term challenges and cuts to our estimates, we're downgrading Kohl's from buy to hold.

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	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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