



# Foot Locker Inc. (FL)

Updated March 7<sup>th</sup>, 2020 by Josh Arnold

## Key Metrics

|                             |      |  |       |                                  |          |
|-----------------------------|------|--|-------|----------------------------------|----------|
| <b>Current Price:</b>       | \$30 | <b>5 Year CAGR Estimate:</b>               | 16.3% | <b>Market Cap:</b>               | \$3,170M |
| <b>Fair Value Price:</b>    | \$45 | <b>5 Year Growth Estimate:</b>             | 4.0%  | <b>Ex-Dividend Date:</b>         | 04/16/20 |
| <b>% Fair Value:</b>        | 67%  | <b>5 Year Valuation Multiple Estimate:</b> | 8.2%  | <b>Dividend Payment Date:</b>    | 05/01/20 |
| <b>Dividend Yield:</b>      | 5.3% | <b>5 Year Price Target</b>                 | \$55  | <b>Years Of Dividend Growth:</b> | 9        |
| <b>Dividend Risk Score:</b> | B    | <b>Retirement Suitability Score:</b>       | A     | <b>Last Dividend Increase:</b>   | 5.3%     |

## 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, which closed in 1997. The athletic apparel retailer, known for its namesake Foot Locker brand, operates almost 3,200 stores in 27 countries. Foot Locker is a \$3.2 billion market capitalization company that should generate more than \$8 billion in revenue this year.

Foot Locker reported fourth quarter and full-year earnings on February 28<sup>th</sup>, and results were somewhat mixed. Revenue for the year came in just over \$8 billion, an increase of 0.8% from 2018. Full-year comparable sales were up 2.2% and excluding forex translation would have risen 2.0%. Net income was up to \$4.93 on a per-share basis in 2019 when adjusted for certain items, up from \$4.71 in the prior year.

Foot Locker continues to see some oscillation in its margin profile as gross margins moved down slightly again in Q4. This caused operating margin for Q4 to decline to 10.5% of revenue, down 50bps year-over-year.

The company guided for full-year 2020 earnings-per-share to increase in the low- to mid-single-digits from 2019's \$4.93, so our initial estimate is for \$5.00. We see potential headwinds from supply shortages coming out of China, where Foot Locker's supply chain is very exposed. We think Foot Locker will use part of its net cash position, as well as its ample cash flow, to continue to reduce the float, helping to offset any weakness that comes from the coronavirus outbreak.

## Growth on a Per-Share Basis

| Year                      | 2010   | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020          | 2025          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>                | \$1.10 | \$1.80 | \$2.58 | \$2.89 | \$3.61 | \$3.84 | \$4.82 | \$3.99 | \$4.71 | \$4.93 | <b>\$5.00</b> | <b>\$6.08</b> |
| <b>DPS</b>                | \$0.60 | \$0.66 | \$0.71 | \$0.78 | \$0.88 | \$1.00 | \$1.10 | \$1.24 | \$1.38 | \$1.49 | <b>\$1.60</b> | <b>\$2.19</b> |
| <b>Shares<sup>1</sup></b> | 155    | 152    | 150    | 146    | 140    | 137    | 132    | 120    | 113    | 105    | <b>98</b>     | <b>80</b>     |

During the last recession, Foot Locker's earnings dipped ~20%, but since then they have sharply rebounded. Indeed, from 2008 through 2018 the company was able to increase earnings-per-share by over 20% annually. However, this was during a time when Foot Locker's net profit margin improved from ~2% to ~7% and the share count was reduced by -25%. Moving forward we are more cautious, albeit still optimistic, on the firm's growth prospects.

Share repurchases ought to continue to aid in bottom line growth, but we do not believe margins will expand at a rate anywhere near what was accomplished in the last decade. This was supported again by Q4 results and indeed, 2019 full-year, as we believe a lower share count will be responsible for the majority (or all) of projected earnings-per-share growth this year.

We're reiterating our growth estimate of 4% annually as tariffs continue to weigh on shoe and apparel retailers, and as the coronavirus has introduced more risks. Foot Locker, buying the vast majority of its inventory from China, is quite exposed to these tariffs and factories shutting down. The current yield is quite high at 5.3% given the still-low valuation.

<sup>1</sup> Share count in millions

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## Valuation Analysis

| Year      | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now  | 2025 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|------|
| Avg. P/E  | 13.7 | 12.1 | 12.6 | 12.3 | 14.0 | 16.9 | 13.4 | 13.0 | 11.3 | 9.7  | 6.1  | 9.0  |
| Avg. Yld. | 4.0% | 3.0% | 2.2% | 2.2% | 1.7% | 1.5% | 1.7% | 2.4% | 2.6% | 3.1% | 5.3% | 4.0% |

Over the past decade, shares of Foot Locker have traded hands with an average P/E ratio of about 14 times earnings. Given the reaction of investors to the coronavirus outbreak, we're sticking with our fair value estimate of 9 times earnings, but that still represents sizable upside to the current trough valuation of just 6.1 times this year's earnings. As such, we see a huge tailwind to total returns from a higher valuation in the coming years. Retailers in general are seeing lower valuations, and given the trade war, we think investors will be reticent to pay more than 9 times earnings for Foot Locker in the near-term. Foot Locker is exceptionally exposed to the trade war and its resulting tariffs, and the stock is reflecting this concern. The virus outbreak is adding concern, but longer-term, Foot Locker's valuation is interesting.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year   | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|--------|------|------|------|------|------|------|------|------|------|------|------|------|
| Payout | 54%  | 36%  | 27%  | 28%  | 24%  | 26%  | 23%  | 31%  | 29%  | 30%  | 32%  | 36%  |

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.

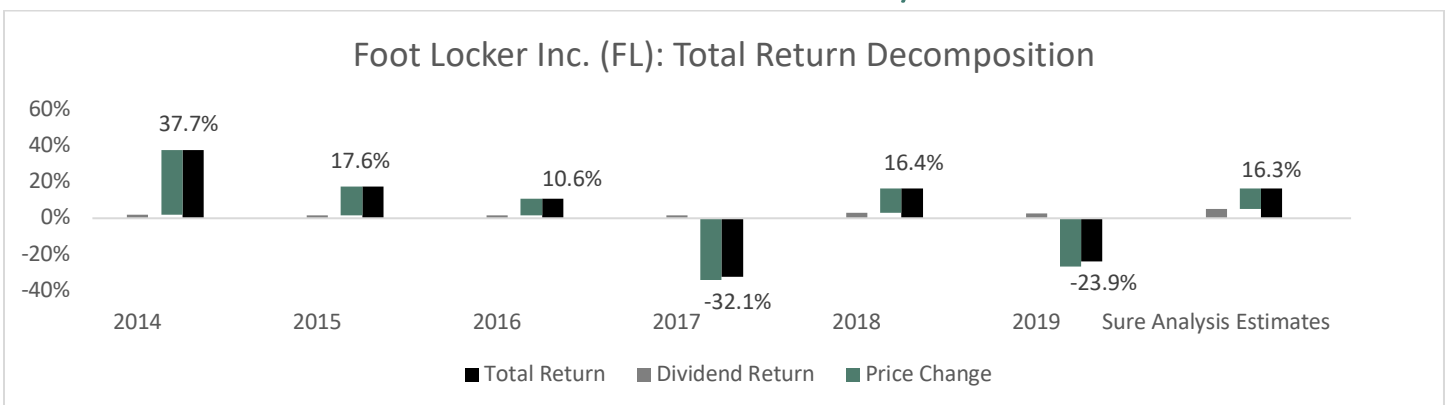
This does not mean that earnings power will not deteriorate in tougher times. During the last recession, Foot Locker posted earnings-per-share of \$0.67, \$0.54 and \$1.10 through the 2008 to 2010 stretch, while the dividend was held steady. This gives a fair indication of the company's ability to withstand tougher times and bounce back.

The company's payout ratio has been reduced significantly since the last recession and stands at less than a third of earnings. This sets up well for faster dividend growth, a robust share repurchase program, or both in the years to come.

## Final Thoughts & Recommendation

With a much lower share price since our last update, as well as a very low valuation, Foot Locker continues to offer very high projected returns. We are forecasting 16.3% annual returns as the high yield, moderate growth, and extremely low valuation make Foot Locker attractive. As such, we see the security as suitable for value investors, those seeking a safe yield for income, and those looking for moderate rates of growth. While the company is exposed to the ongoing trade war with China, it continues to execute well on the things it can control, and we rate it a buy.

## Total Return Breakdown by Year



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## Income Statement Metrics

| Year                    | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Revenue</b>          | 5,049 | 5,623 | 6,182 | 6,505 | 7,151 | 7,412 | 7,766 | 7,782 | 7,939 | 8,005 |
| <b>Gross Profit</b>     | 1,516 | 1,796 | 2,034 | 2,133 | 2,374 | 2,505 | 2,636 | 2,456 | 2,528 | 2,543 |
| <b>Gross Margin</b>     | 30.0% | 31.9% | 32.9% | 32.8% | 33.2% | 33.8% | 33.9% | 31.6% | 31.8% | 31.8% |
| <b>SG&amp;A Exp.</b>    | 1,138 | 1,244 | 1,294 | 1,334 | 1,426 | 1,415 | 1,472 | 1,501 | 1,614 | 1,650 |
| <b>D&amp;A Exp.</b>     | 106   | 110   | 118   | 133   | 139   | 148   | 158   | 173   | 178   |       |
| <b>Operating Profit</b> | 272   | 442   | 622   | 666   | 809   | 942   | 1,006 | 782   | 736   | 714   |
| <b>Operating Margin</b> | 5.4%  | 7.9%  | 10.1% | 10.2% | 11.3% | 12.7% | 13.0% | 10.0% | 9.3%  | 8.9%  |
| <b>Net Profit</b>       | 169   | 278   | 397   | 429   | 520   | 541   | 664   | 284   | 541   | 498   |
| <b>Net Margin</b>       | 3.3%  | 4.9%  | 6.4%  | 6.6%  | 7.3%  | 7.3%  | 8.6%  | 3.6%  | 6.8%  | 6.2%  |
| <b>Free Cash Flow</b>   | 229   | 345   | 253   | 324   | 522   | 563   | 578   | 539   | 594   |       |
| <b>Income Tax</b>       | 88    | 157   | 210   | 234   | 289   | 296   | 340   | 294   | 172   | 184   |

## Balance Sheet Metrics

| Year                            | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|---------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Total Assets</b>             | 2,896 | 3,050 | 3,367 | 3,487 | 3,577 | 3,775 | 3,840 | 3,961 | 3,820 | 6,599 |
| <b>Cash &amp; Equivalents</b>   | 696   | 851   | 880   | 858   | 967   | 1,021 | 1,046 | 849   | 891   | 907   |
| <b>Accounts Receivable</b>      | 41    | 49    | 68    | 99    | 78    | 94    | 101   | 106   | 87    |       |
| <b>Inventories</b>              | 1,059 | 1,069 | 1,167 | 1,220 | 1,250 | 1,285 | 1,307 | 1,278 | 1,269 | 1,208 |
| <b>Goodwill &amp; Int. Ass.</b> | 217   | 198   | 185   | 230   | 206   | 201   | 197   | 206   | 181   |       |
| <b>Total Liabilities</b>        | 871   | 940   | 990   | 991   | 1,081 | 1,222 | 1,130 | 1,442 | 1,314 | 4,119 |
| <b>Accounts Payable</b>         | 223   | 240   | 298   | 263   | 301   | 279   | 249   | 258   | 387   | 333   |
| <b>Long-Term Debt</b>           | 137   | 135   | 133   | 136   | 132   | 129   | 127   | 125   | 124   | 122   |
| <b>Shareholder's Equity</b>     | 2,025 | 2,110 | 2,377 | 2,496 | 2,496 | 2,553 | 2,710 | 2,519 | 2,506 | 2,480 |
| <b>D/E Ratio</b>                | 0.07  | 0.06  | 0.06  | 0.05  | 0.05  | 0.05  | 0.05  | 0.05  | 0.05  | 0.05  |

## Profitability & Per Share Metrics

| Year                    | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  |
|-------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>Return on Assets</b> | 5.9%  | 9.4%  | 12.4% | 12.5% | 14.7% | 14.7% | 17.4% | 7.3%  | 13.9% | 9.6%  |
| <b>Return on Equity</b> | 8.5%  | 13.4% | 17.7% | 17.6% | 20.8% | 21.4% | 25.2% | 10.9% | 21.5% | 20.0% |
| <b>ROIC</b>             | 8.0%  | 12.6% | 16.7% | 16.7% | 19.8% | 20.4% | 24.1% | 10.4% | 20.5% | 19.0% |
| <b>Shares Out.</b>      | 155   | 152   | 150   | 146   | 140   | 137   | 132   | 120   | 113   | 105   |
| <b>Revenue/Share</b>    | 32.22 | 36.42 | 40.14 | 43.22 | 48.98 | 52.64 | 57.48 | 60.84 | 68.38 | 73.37 |
| <b>FCF/Share</b>        | 1.46  | 2.23  | 1.64  | 2.15  | 3.58  | 4.00  | 4.28  | 4.21  | 5.12  |       |

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

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