



Foot Locker Inc. (FL)

Updated June 8th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$33	5 Year CAGR Estimate:	3.0%	Market Cap:	\$3.5 B
Fair Value Price:	\$29	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	N/A
% Fair Value:	114%	5 Year Valuation Multiple Estimate:	-2.6%	Dividend Payment Date:	N/A
Dividend Yield:	N/A	5 Year Price Target	\$36	Years Of Dividend Growth:	N/A
Dividend Risk Score:	N/A	Retirement Suitability Score:	N/A	Last Dividend Increase:	N/A

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 \$3.5 billion market capitalization company that should generate more than \$6 billion in revenue this year.

Foot Locker reported first quarter earnings on May 22nd with results coming in weaker than expected on both the top and bottom lines. The company reported a net loss of -\$98 million, or -\$0.93 per share, which was down from a profit of \$172 million, or \$1.52 per share in the year-ago period.

First quarter sales declined -43.4% to \$1.2 billion, down from \$2.1 billion in last year's Q1. Comparable sales plummeted -42.8% due to store closures and reduced demand.

Gross margin was 23% of revenue, down from 33.2% a year ago, while SG&A costs were 26.9% of revenue, up from 20% in last year's Q1. Deleveraging of both gross margin and SG&A were due to significant sales declines.

Foot Locker also suspended all capital returns, including dividends and buybacks. We've cut our estimate of earnings-per-share to 75 cents for this year, but are using an earnings power estimate of \$3.25 for our fair value and valuation calculations to reduce the impact of temporary headwinds from COVID-19.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.10	\$1.80	\$2.58	\$2.89	\$3.61	\$3.84	\$4.82	\$3.99	\$4.71	\$4.93	\$0.75	\$3.95
DPS	\$0.60	\$0.66	\$0.71	\$0.78	\$0.88	\$1.00	\$1.10	\$1.24	\$1.38	\$1.49	---	\$0.79
Shares¹	155	152	150	146	140	137	132	120	113	105	98	80

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 have been temporarily suspended, but ought to aid in bottom line growth in the future. However, we do not believe margins will expand at a rate anywhere near what was accomplished in the last decade. This was supported again by recent results. We think Foot Locker will return to profitability quickly, and that will enable capital returns once again.

We're reiterating our growth estimate of 4% annually from our earnings power base 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 once-attractive yield is now zero as the dividend has been temporarily eliminated.

¹ Share count in millions

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	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	10.3	9.0
Avg. Yld.	4.0%	3.0%	2.2%	2.2%	1.7%	1.5%	1.7%	2.4%	2.6%	3.1%	---	2.2%

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, and shares trade in excess of that at 10.3 times earnings power. As such, we see a small headwind 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.

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%	---	20%

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.

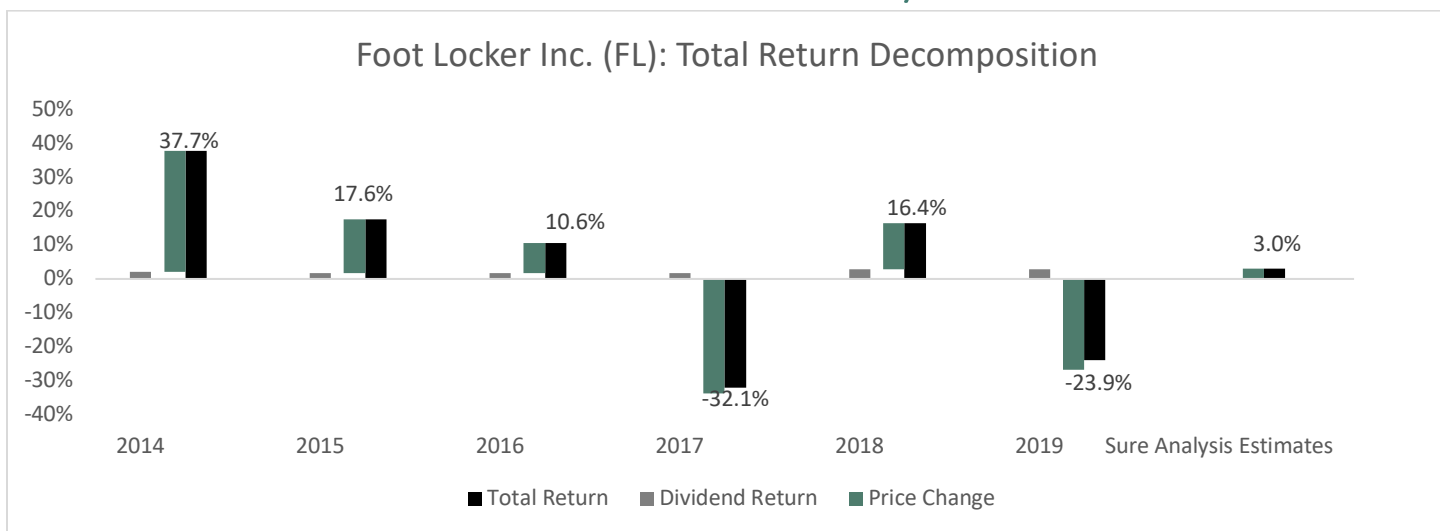
This does not mean that earnings power will not deteriorate in tougher times. During the last recession, Foot Locker posted earnings-per-share of \$0.67, \$0.54 and \$1.10 through the 2008 to 2010 stretch, while the dividend was held steady. This gives a fair indication of the company's ability to withstand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

The payout ratio is at zero now that the dividend has been suspended, but we expect Foot Locker will return to paying cash to shareholders in the relatively near future.

Final Thoughts & Recommendation

We're giving Foot Locker a two-notch downgrade from buy to sell as total returns are now projected at just 3% annually. The once-attractive dividend is now gone, and with earnings power deteriorating while the share price remains largely stable, the valuation has become much more unfavorable. We think there are better opportunities for investors.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	5,049	5,623	6,182	6,505	7,151	7,412	7,766	7,782	7,939	8,005
Gross Profit	1,516	1,796	2,034	2,133	2,374	2,505	2,636	2,456	2,528	2,543
Gross Margin	30.0%	31.9%	32.9%	32.8%	33.2%	33.8%	33.9%	31.6%	31.8%	31.8%
SG&A Exp.	1,138	1,244	1,294	1,334	1,426	1,415	1,472	1,501	1,614	1,650
D&A Exp.	106	110	118	133	139	148	158	173	178	179
Operating Profit	272	442	622	666	809	942	1,006	782	736	714
Operating Margin	5.4%	7.9%	10.1%	10.2%	11.3%	12.7%	13.0%	10.0%	9.3%	8.9%
Net Profit	169	278	397	429	520	541	664	284	541	498
Net Margin	3.3%	4.9%	6.4%	6.6%	7.3%	7.3%	8.6%	3.6%	6.8%	6.2%
Free Cash Flow	229	345	253	324	522	563	578	539	594	509
Income Tax	88	157	210	234	289	296	340	294	172	184

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2,896	3,050	3,367	3,487	3,577	3,775	3,840	3,961	3,820	6,599
Cash & Equivalents	696	851	880	858	967	1,021	1,046	849	891	907
Accounts Receivable	41	49	68	99	78	94	101	106	87	100
Inventories	1,059	1,069	1,167	1,220	1,250	1,285	1,307	1,278	1,269	1,208
Goodwill & Int. Ass.	217	198	185	230	206	201	197	206	181	176
Total Liabilities	871	940	990	991	1,081	1,222	1,130	1,442	1,314	4,119
Accounts Payable	223	240	298	263	301	279	249	258	387	333
Long-Term Debt	137	135	133	136	132	129	127	125	124	122
Shareholder's Equity	2,025	2,110	2,377	2,496	2,496	2,553	2,710	2,519	2,506	2,480
D/E Ratio	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
Return on Assets	5.9%	9.4%	12.4%	12.5%	14.7%	14.7%	17.4%	7.3%	13.9%	9.6%
Return on Equity	8.5%	13.4%	17.7%	17.6%	20.8%	21.4%	25.2%	10.9%	21.5%	20.0%
ROIC	8.0%	12.6%	16.7%	16.7%	19.8%	20.4%	24.1%	10.4%	20.5%	19.0%
Shares Out.	155	152	150	146	140	137	132	120	113	105
Revenue/Share	32.22	36.42	40.14	43.22	48.98	52.64	57.48	60.84	68.38	73.37
FCF/Share	1.46	2.23	1.64	2.15	3.58	4.00	4.28	4.21	5.12	4.67

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

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