



# Foot Locker Inc. (FL)

Updated August 29<sup>th</sup>, 2020 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$30	<b>5 Year CAGR Estimate:</b>	5.3%	<b>Market Cap:</b>	\$3.1 B
<b>Fair Value Price:</b>	\$36	<b>5 Year Growth Estimate:</b>	0.0%	<b>Ex-Dividend Date:</b>	10/15/20
<b>% Fair Value:</b>	84%	<b>5 Year Valuation Multiple Estimate:</b>	3.4%	<b>Dividend Payment Date:</b>	10/30/20
<b>Dividend Yield:</b>	2.0%	<b>5 Year Price Target</b>	\$36	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	D	<b>Retirement Suitability Score:</b>	D	<b>Last Dividend Increase:</b>	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 more than 3,000 stores in 27 countries. Foot Locker is a \$3.1 billion market capitalization company that should generate more than \$7 billion in revenue this year.

Foot Locker reported second quarter earnings on August 21<sup>st</sup>, 2020 with results coming in much better than expected on the top and bottom lines. Total revenue was off -17% year-over-year as the company struggled with forex fluctuations, as well as a huge decline in comparable sales. Foot Locker is also still in the process of right-sizing its store base, and it closed 74 net stores in the past year, with the store count now sitting at 3,100 worldwide.

Inventory fell to meet lower demand, but only by -2.7% to \$1.2 billion. Cash and equivalents ended the quarter at \$1.37 billion, with \$121 million in debt as the company repaid \$330 million from a previous draw down against its revolving credit facility.

We now expect \$1.70 in EPS this year, which is up sharply from our prior expectation, as demand has returned much more quickly than originally planned. However, we note that we are using an earnings power estimate of \$4 per share to account for one-time impacts of COVID-19.

Importantly, Foot Locker also reinstated its dividend after suspending it earlier this year. The new payout is just \$0.60 on an annualized basis, down from \$1.49 last year.

## 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>\$1.70</b>	<b>\$4.00</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>\$0.60</b>	<b>\$0.70</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 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. The dividend has been reinstated, but there has been no word on renewed share repurchases.

We're moving our growth estimate to 0% annually from our earnings power base as the coronavirus has introduced more risks. Foot Locker, buying the vast majority of its inventory from China, is quite exposed to tariffs and factories

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

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shutting down as the trade war continues between the US and China. The once-attractive yield is now much less so given the lower payout.

## 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	7.6	9.0
Avg. Yld.	4.0%	3.0%	2.2%	2.2%	1.7%	1.5%	1.7%	2.4%	2.6%	3.1%	2.0%	1.9%

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 shares trade well under that at 7.6 times earnings power. As such, we see a 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.

## 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%	15%	17%

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.

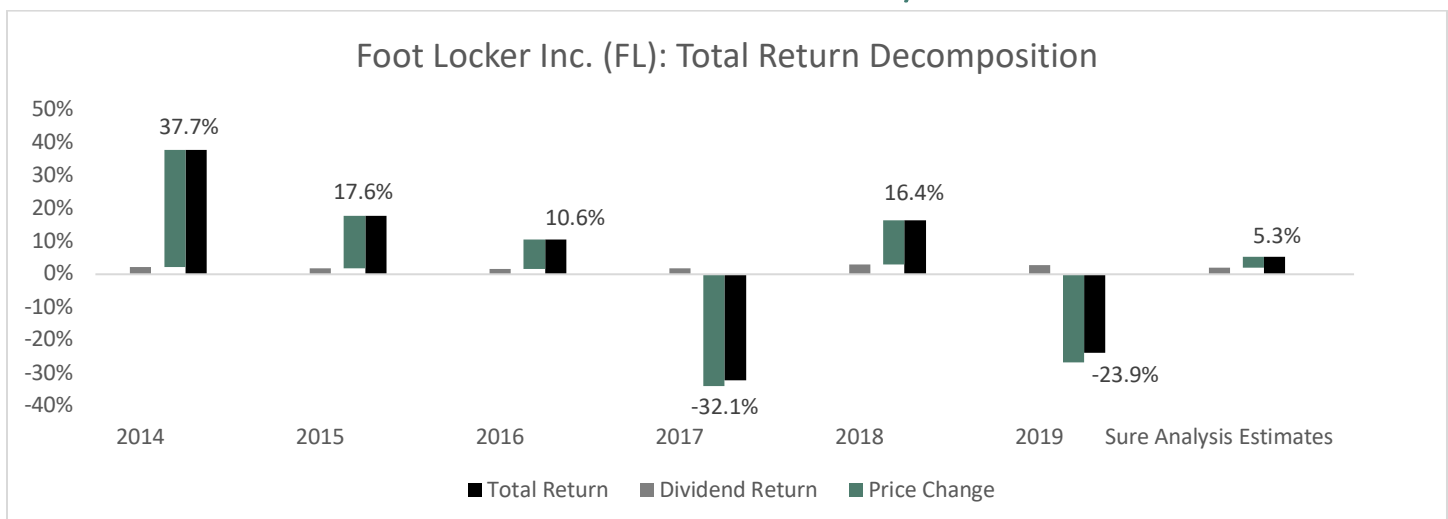
This does not mean that earnings power will not deteriorate in tougher times. During the last recession, Foot Locker posted earnings-per-share of \$0.67, \$0.54 and \$1.10 through the 2008 to 2010 stretch, while the dividend was held steady. This gives a fair indication of the company's ability to withstand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

The new dividend is quite low relative to earnings, so the payout should be safe for the foreseeable future.

## Final Thoughts & Recommendation

We're upgrading Foot Locker from sell to hold as total returns are now projected at 5.3% annually. Despite the yield being much lower than it has been, as well as reduced growth expectations, we see Foot Locker as attractively valued.

## 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	179
<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	509
<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	100
<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	176
<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	4.67

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

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