



Kohl's Corporation (KSS)

Updated September 8th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$19	5 Year CAGR Estimate:	2.2%	Market Cap:	\$3.5 B
Fair Value Price:	\$16	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	N/A
% Fair Value:	120%	5 Year Valuation Multiple Estimate:	-3.6%	Dividend Payment Date:	N/A
Dividend Yield:	0.0%	5 Year Price Target	\$18	Years Of Dividend Growth:	N/A
Dividend Risk Score:	N/A	Retirement Suitability Score:	N/A	Last Dividend Increase:	N/A

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 1,000 stores in 49 states. The \$3.5 billion market capitalization company should generate about \$15 billion in sales this year.

Kohl's reported second quarter earnings on August 18th, with results coming in better than expected on both the top and bottom lines. The company declined to report comparable sales, but total revenue was off -23% year-over-year, coming in at \$3.41 billion in Q2. Kohl's was impacted by store closures and reduced capacity, in addition to higher operating costs during Q2 from COVID-19.

Gross margins fell 569bps year-over-year to 33.1% as a result of increased promotional activity, as well as unfavorable mix shift. Kohl's also reported higher shipping costs as more merchandise was sent directly to consumers. SG&A costs were up 220bps to 30.8% of revenue, squeezing operating margins by nearly 6% when combined with the decline in gross margins.

The company sold through a staggering 26% of its inventory, ending the period with just \$2.7 billion on hand. It also sold two facilities for total proceeds of \$193 million to raise cash. Free cash flow came to \$196 million and the company had \$2.4 billion in cash at the end of Q2.

We've tweaked our estimate of earnings-per-share to a loss of -\$3.30 for this year, but note that for valuation and fair value calculations, we are using estimated earnings power of \$2.00 per share.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$3.65	\$4.30	\$4.17	\$4.05	\$4.24	\$3.46	\$3.11	\$4.19	\$5.60	\$4.86	-\$3.30	\$2.21
DPS	---	\$1.00	\$1.28	\$1.40	\$1.56	\$1.80	\$2.00	\$2.20	\$2.44	\$2.68	---	\$0.88
Shares¹	291	247	222	211	201	186	174	168	165	154	155	135

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 (\$769 million in 2019 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 produced a -13% decline in 2019, and earnings will decline enormously this year.

With the share repurchase program now suspended indefinitely, we've boosted our estimate of the share count over time, which will slow EPS growth. In addition, we think Kohl's will struggle with margins as its stores reopen, with reduced capacity and additional costs related to COVID-19. We see earnings-per-share at just \$2.21 by 2025.

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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Kohl's capital return program was a huge draw for the stock but with dividends and buyback suspended, we see little reason for investors to jump in. We do see a partial recovery in the dividend to \$0.88 per share by 2025, but that is quite dependent upon earnings normalizing at some point.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	14.3	11.9	11.7	12.7	13.2	17.1	14.1	10.4	11.9	11.3	9.6	8.0
Avg. Yld.	---	2.0%	2.6%	2.7%	2.8%	3.1%	4.6%	5.1%	3.7%	4.9%	---	5.0%

Given the extremely unusual circumstances of today's environment, we are using an earnings power estimate of \$2.00 per share for our fair value and valuation calculations, rather than actual estimates for 2020.

Over the past decade, shares of Kohl's have routinely traded hands with an average multiple of nearly 13 times earnings. However, given weak Q2 results, along with declining valuations in the sector, we believe investors will be less willing to pay 13 times earnings or more in the near-term, and maintain our estimate of fair value at 8 times earnings. The yield is currently zero until further notice, but we see the stock as paying a dividend again in the coming years.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	---	23%	30%	34%	37%	52%	64%	64%	44%	55%	---	40%

We see the payout ratio increasing back to about 40% of earnings over time after the dividend is reinstated.

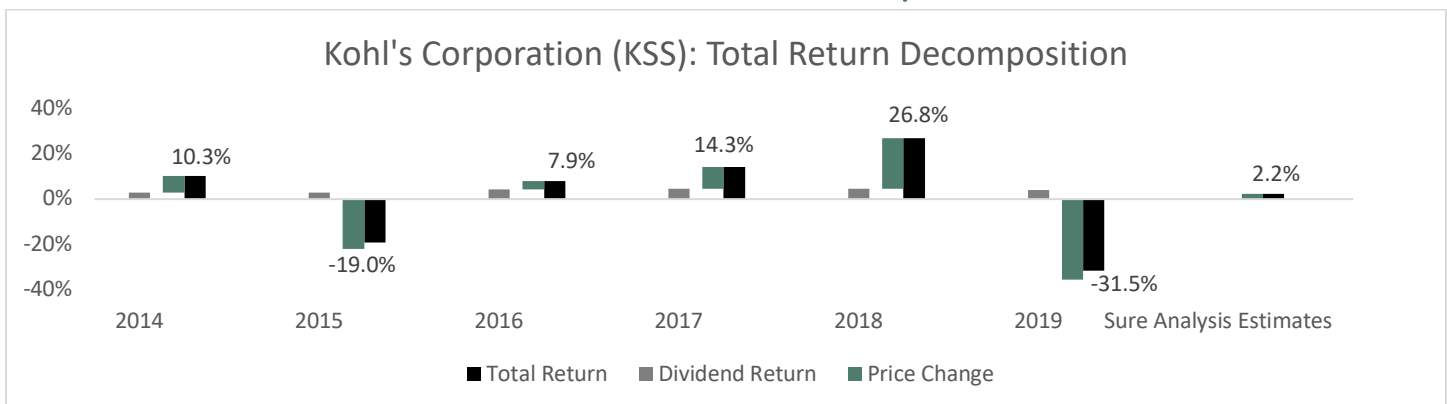
Compared to other retailers we believe Kohl's has a competitive advantage in the way of a well-entrenched store footprint outside of large malls, private-label brands, a large loyalty program, and an Amazon return service. This is offset somewhat by the competitive nature of the business, but it still allows Kohl's to stand out. Unfortunately, this reliance upon physical stores is more of a curse than a blessing in today's environment.

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. Damage will be much worse for this recession, however, and indeed, already has proven as such through Q2.

Final Thoughts & Recommendation

Kohl's projected total returns now stand at just 2.2%, but we note that there is extreme uncertainty around this company's long-term future. Therefore, given the uncertainty inherent in the company's outlook, as well as poor projected total returns, we're moving Kohl's from hold to sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	18,391	18,804	19,279	19,031	19,023	19,204	19,681	20,084	20,229	19,974
Gross Profit	7,032	7,179	6,990	6,944	6,925	6,939	7,737	7,908	8,030	7,834
Gross Margin	38.2%	38.2%	36.3%	36.5%	36.4%	36.1%	39.3%	39.4%	39.7%	39.2%
SG&A Exp.	4,190	4,243	4,267	4,313	4,350	4,452	5,430	5,501	5,601	5,705
D&A Exp.	750	778	833	889	886	934	938	991	964	917
Operating Profit	2,092	2,158	1,890	1,742	1,689	1,553	1,369	1,416	1,465	1,212
Op. Margin	11.4%	11.5%	9.8%	9.2%	8.9%	8.1%	7.0%	7.1%	7.2%	6.1%
Net Profit	1,120	1,167	986	889	867	673	556	859	801	691
Net Margin	6.1%	6.2%	5.1%	4.7%	4.6%	3.5%	2.8%	4.3%	4.0%	3.5%
Free Cash Flow	949	1,212	480	1,241	1,342	794	1,385	1,019	1,529	802
Income Tax	668	692	575	515	482	384	319	258	241	210

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	13,564	14,148	13,905	14,357	14,333	13,606	13,574	13,389	12,469	14,555
Cash & Equivalents	2,277	1,205	537	971	1,407	707	1,074	1,308	934	723
Inventories	3,036	3,216	3,748	3,874	3,814	4,038	3,795	3,542	3,475	3,537
Total Liabilities	5,462	7,640	7,857	8,379	8,342	8,115	8,397	7,970	6,942	9,105
Accounts Payable	1,138	1,233	1,307	1,365	1,511	1,251	1,507	1,271	1,187	1,206
Long-Term Debt	2,096	2,141	2,492	2,792	2,780	2,792	2,795	2,797	1,861	1,856
Total Equity	8,102	6,508	6,048	5,978	5,991	5,491	5,177	5,419	5,527	5,450
D/E Ratio	0.26	0.33	0.41	0.47	0.46	0.51	0.54	0.52	0.34	0.34

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	8.0%	8.4%	7.0%	6.3%	6.0%	4.8%	4.1%	6.4%	6.2%	5.1%
Return on Equity	14.3%	16.0%	15.7%	14.8%	14.5%	11.7%	10.4%	16.2%	14.6%	12.6%
ROIC	10.3%	12.4%	11.5%	10.3%	9.9%	7.9%	6.8%	10.6%	10.3%	9.4%
Shares Out.	291	247	222	211	201	186	174	168	165	154
Revenue/Share	60.10	69.39	81.35	86.50	93.25	98.48	109.95	119.55	122.60	126.42
FCF/Share	3.10	4.47	2.03	5.64	6.58	4.07	7.74	6.07	9.27	5.08

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

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