



The Kroger Co. (KR)

Updated March 4th, 2021 by Eli Inkrot

Key Metrics

| | | | | | |
|-----------------------------|------|--|------|---|----------|
| Current Price: | \$34 | 5 Year CAGR Estimate: | 5.5% | Market Cap: | \$26 B |
| Fair Value Price: | \$34 | 5 Year Growth Estimate: | 3.0% | Ex-Dividend Date¹: | 05/14/21 |
| % Fair Value: | 99% | 5 Year Valuation Multiple Estimate: | 0.2% | Dividend Payment Date¹: | 06/01/21 |
| Dividend Yield: | 2.1% | 5 Year Price Target | \$40 | Years Of Dividend Growth: | 15 |
| Dividend Risk Score: | A | Retirement Suitability Score: | B | Last Dividend Increase: | 12.5% |

Overview & Current Events

Founded in 1883 and headquartered in Cincinnati, Ohio, Kroger is one of the largest retailers in the U.S. The company has nearly 2,800 retail stores under two dozen banners, 1,500 fuel centers, 2,200 pharmacies and 170 jewelry stores in 35 states. The \$26 billion company serves more than 60 million households every year.

On June 25th, 2020 Kroger announced a 12.5% dividend increase, from \$0.16 to \$0.18 per quarter.

On March 4th, 2021 Kroger reported Q4 and full year 2020 results for the period ending January 30th, 2021. For the quarter Kroger reported \$30.74 billion in sales, up from \$28.89 billion in Q4 2019. Identical sales excluding fuel were up 10.6%, as the company continued to see a benefit from the COVID-19 pandemic as more consumers are eating at home. After being up 92%, 127% and 108% in the last three quarters, digital sales were up 118% in Q4. Kroger posted a loss during the quarter, but this was due to a pension charge. On an adjusted basis earnings-per-share equaled \$0.81 compared to \$0.57 in Q4 2019.

For the year Kroger generated sales of \$132.5 billion, representing an 8.4% increase compared to 2019. Identical sales excluding fuel were up 14.1%. Digital sales improved 116% versus the prior year. Adjusted earnings-per-share equaled \$3.47, ahead of prior guidance, compared to \$2.19 in 2019.

Kroger also provided 2021 guidance. For this year the company anticipates identical sales declining -3.0% to -5.0% and adjusted earnings-per-share of \$2.75 to \$2.95. While these metrics represent declines compared to 2020, the two-year growth rate compared to 2019 is still expected to be significantly positive.

Growth on a Per-Share Basis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| EPS | \$1.00 | \$1.32 | \$1.43 | \$1.76 | \$2.06 | \$2.12 | \$2.04 | \$2.11 | \$2.19 | \$3.47 | \$2.85 | \$3.30 |
| DPS | \$0.22 | \$0.27 | \$0.32 | \$0.35 | \$0.41 | \$0.47 | \$0.50 | \$0.55 | \$0.60 | \$0.68 | \$0.72 | \$1.06 |
| Shares² | 1,122 | 1,028 | 1,016 | 974 | 967 | 924 | 870 | 798 | 805 | 781 | 770 | 725 |

In the 2008 through 2019 period Kroger grew its earnings-per-share by an 7.9% average annual rate. The company failed to grow its earnings-per-share significantly in the 2015 through 2019 timeframe due to the fierce competition in the retail sector. Prior to last year, growth was difficult to come by.

Of course, that has changed dramatically as of late. The COVID-19 pandemic, which has plagued many businesses, has been a tailwind for groceries and Kroger in particular. To this point, earnings were significantly higher in 2020, marking a banner year. Aside from the pandemic, Kroger does have some other growth levers available. For instance, Kroger can continue to improve its margins via its "Restock Kroger" plan. Moreover, the company has reduced its share count significantly over the last decade.

Still, growth is going to be difficult using 2020 as a high-water mark, with management guiding for -15% to -20% lower results this year. We are using the midpoint of management's guidance and a 3% intermediate-term growth rate.

¹ Estimate

² In millions.

Disclosure: This analyst is long the security discussed in this research report.



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Valuation Analysis

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Now | 2026 |
|------------------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| Avg. P/E | 11.8 | 9.1 | 12.9 | 14.5 | 18.2 | 16.4 | 12.8 | 13.2 | 11.6 | 9.2 | 11.9 | 12.0 |
| Avg. Yld. | 1.9% | 2.2% | 1.7% | 1.4% | 1.1% | 1.3% | 1.9% | 2.0% | 2.4% | 2.1% | 2.1% | 2.7% |

During the last decade shares of Kroger have traded hands with an average P/E ratio of about 13 times earnings. We have reduced our estimate slightly to 12 times earnings, as growth expectations are not as robust moving forward, 2020 notwithstanding. With shares trading near 12 times expected earnings, this implies little influence from the valuation.

Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2026 |
|---------------|------|------|------|------|------|------|------|------|------|------|------------|------------|
| Payout | 22% | 20% | 22% | 20% | 20% | 22% | 25% | 26% | 27% | 20% | 25% | 32% |

Although the large scale and reach of Kroger offers some economies of scale, and thus a competitive advantage, competition has heated up more than ever in the retail sector. As a result, Kroger lacks a meaningful moat.

Still, while most companies saw their earnings collapse during the Great Recession, Kroger exhibited exceptional resilience posting earnings-per-share results of \$0.95, \$0.87, \$0.87 and \$1.00 during the 2008 through 2011 stretch. Kroger always operates at a razor-thin margin, in-between 1% and 2%, which allows it to keep competitors at bay but also means that the stock is extremely sensitive to competitive pricing pressures.

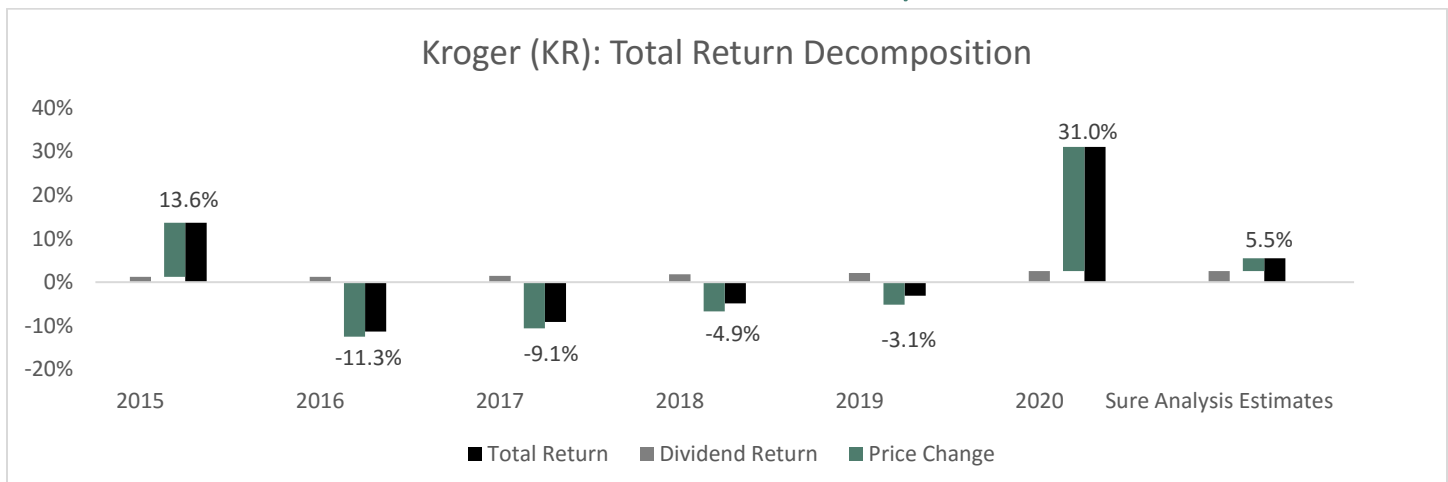
Kroger has been prudent about its dividend, with a payout ratio sticking around the 20% to 30% range. The larger capital return focus has been, and likely will continue to be, on share repurchases. We believe this is prudent considering the competitive landscape of Kroger's industry.

At the end of quarter Kroger held \$371 million in cash, \$12.5 billion in current assets (57% of which is inventory) and \$48.6 billion in total assets (46% of which is property and equipment) against \$15.4 billion in current liabilities and \$39.1 billion in total liabilities. Long-term debt stood at \$12.5 billion against underlying earnings power of about \$2.2 billion.

Final Thoughts & Recommendation

Shares are up 9% since our last report. Kroger has proven to be a strong and resilient business, but the industry is not getting any easier, although results improved dramatically amid the pandemic. We see the potential for 5.5% annual returns, stemming from 3% growth and a 2.1% starting yield. Shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------|-------|-------|-------|-------|--------|--------|-------|--------|--------|--------|
| Revenue (\$B) | 90.27 | 96.62 | 98.38 | 108.5 | 109.83 | 115.34 | 122.7 | 121.16 | 121.85 | 122.29 |
| Gross Profit | 18880 | 19893 | 20237 | 22953 | 24334 | 25835 | 27000 | 26268 | 26750 | 26992 |
| Gross Margin | 20.9% | 20.6% | 20.6% | 21.2% | 22.2% | 22.4% | 22.0% | 21.7% | 22.0% | 22.1% |
| SG&A Exp. | 15964 | 15477 | 15809 | 17868 | 18669 | 20059 | 22479 | 21189 | 21670 | 22092 |
| D&A Exp. | 1638 | 1652 | 1703 | 1948 | 2089 | 2340 | 2436 | 2465 | 2465 | 3289 |
| Operating Profit | 1278 | 2764 | 2725 | 3137 | 3576 | 3436 | 2085 | 2614 | 2614 | 2251 |
| Op. Margin | 1.4% | 2.9% | 2.8% | 2.9% | 3.3% | 3.0% | 1.7% | 2.2% | 2.1% | 1.8% |
| Net Profit | 602 | 1497 | 1519 | 1728 | 2039 | 1975 | 1907 | 3110 | 3110 | 1659 |
| Net Margin | 0.7% | 1.5% | 1.5% | 1.6% | 1.9% | 1.7% | 1.6% | 2.6% | 2.6% | 1.4% |
| Free Cash Flow | 760 | 892 | 1243 | 1384 | 1568 | 573 | 604 | 1197 | 1197 | 1536 |
| Income Tax | 247 | 794 | 751 | 902 | 1045 | 957 | -405 | 900 | 900 | 469 |

Balance Sheet Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Total Assets | 23476 | 24634 | 29281 | 30497 | 33897 | 36505 | 37197 | 38118 | 38120 | 45164 |
| Cash & Equivalents | 188 | 238 | 401 | 268 | 277 | 322 | 347 | 429 | 429 | 399 |
| Acc. Receivable | 949 | 1051 | 1116 | 1266 | 1734 | 1649 | 1637 | 1589 | 1589 | 1692 |
| Inventories | 5114 | 5146 | 5651 | 5688 | 6168 | 6561 | 6533 | 6846 | 6846 | 7084 |
| Goodwill & Int. | 1138 | 1364 | 2837 | 3061 | 3777 | 4184 | 4025 | 4345 | 4345 | 4142 |
| Total Liabilities | 19510 | 20420 | 23886 | 25055 | 27099 | 29795 | 30292 | 30283 | 30280 | 36591 |
| Accounts Payable | 4329 | 4484 | 4881 | 5052 | 5728 | 5818 | 5858 | 6059 | 6059 | 6349 |
| Long-Term Debt | 8165 | 8879 | 11310 | 11597 | 12079 | 14077 | 15589 | 15229 | 14350 | 14076 |
| Total Equity | 3981 | 4207 | 5384 | 5412 | 6820 | 6698 | 6931 | N/A | 7886 | 8573 |
| D/E Ratio | 2.05 | 2.11 | 2.10 | 2.14 | 1.77 | 2.10 | 2.25 | N/A | 1.82 | 1.64 |

Profitability & Per Share Metrics

| Year | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|-------------------------|-------|-------|-------|--------|--------|--------|--------|--------|-------|--------|
| Return on Assets | 2.6% | 6.2% | 5.6% | 5.8% | 6.3% | 5.6% | 5.2% | 8.3% | 8.3% | 4.0% |
| Return on Equity | 13.0% | 36.6% | 31.7% | 32.0% | 33.3% | 29.2% | 28.0% | N/A | 42.0% | 20.1% |
| ROIC | 4.8% | 11.9% | 10.2% | 10.2% | 11.4% | 10.0% | 8.8% | N/A | 13.9% | 7.5% |
| Shares Out. | 1,122 | 1,028 | 1,016 | 974 | 967 | 924 | 870 | 798 | 818 | 805 |
| Revenue/Share | 76.11 | 89.96 | 94.59 | 109.23 | 112.07 | 120.39 | 135.69 | 148.12 | 149.0 | 151.91 |
| FCF/Share | 0.64 | 0.83 | 1.20 | 1.39 | 1.60 | 0.60 | 0.67 | 1.46 | 1.46 | 1.91 |

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

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