



The Kroger Co. (KR)

Updated June 18th, 2021, by Eli Inkrot

Key Metrics

Current Price:	\$39	5 Year CAGR Estimate:	5.1%	Market Cap:	\$29 B
Fair Value Price:	\$39	5 Year Growth Estimate:	3.0%	Ex-Dividend Date¹:	08/13/21
% Fair Value:	99%	5 Year Valuation Multiple Estimate:	0.1%	Dividend Payment Date¹:	09/01/21
Dividend Yield:	1.9%	5 Year Price Target	\$45	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 2,800 retail stores under two dozen banners, 1,500 fuel centers, 2,200 pharmacies and 170 jewelry stores in 35 states. The \$29 billion company serves more than 60 million households every year.

On June 17th, 2021, Kroger reported Q1 fiscal year 2021 results for the period ending May 22nd, 2021. (Kroger's fiscal year ends the Saturday closest January 31st.) For the quarter Kroger reported \$41.3 billion in sales, down -0.6% compares to Q1 2020, as the company begins to lap the record results driven stockpiling amidst the COVID-19 pandemic. After being up 92%, 127%, 108% and 118% in the past four quarters, digital sales were up 16% year-over-year, as this portion of the business begins to normalize. Identical sales excluding fuel were down -4.1%. Meanwhile, adjusted earnings-per-share equaled \$1.19 compared to \$1.22 in Q1 2020.

Kroger also updated its fiscal 2021 guidance. The company now expects identical sales declining -4.0% to -2.5% (from -3.0% to -5.0%) and adjusted earnings-per-share of \$2.95 to \$3.10 (from \$2.75 to \$2.95 previously). We have updated our forecast accordingly. While these metrics represent declines compared to 2020, the two-year growth rate compared to 2019 is still expected to be significantly positive.

In addition, Kroger approved a new \$1 billion share repurchase authorization.

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	\$3.00	\$3.48
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	788	758	760	700

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 and digital sales continue to be strong.

Compared to 2020, growth is going to be difficult with management guiding for lower results this year. We are estimating \$3.00 in earnings-per-share this year to go along with 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	9.4	12.9	13.0
Avg. Yld.	1.9%	2.2%	1.7%	1.4%	1.1%	1.3%	1.9%	2.0%	2.4%	2.1%	1.9%	2.3%

During the last decade shares of Kroger have traded hands with an average P/E ratio of about 13 times earnings. We are using this as our starting fair value baseline. With shares trading near 13 times expected earnings, this implies little change 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%	24%	30%

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.

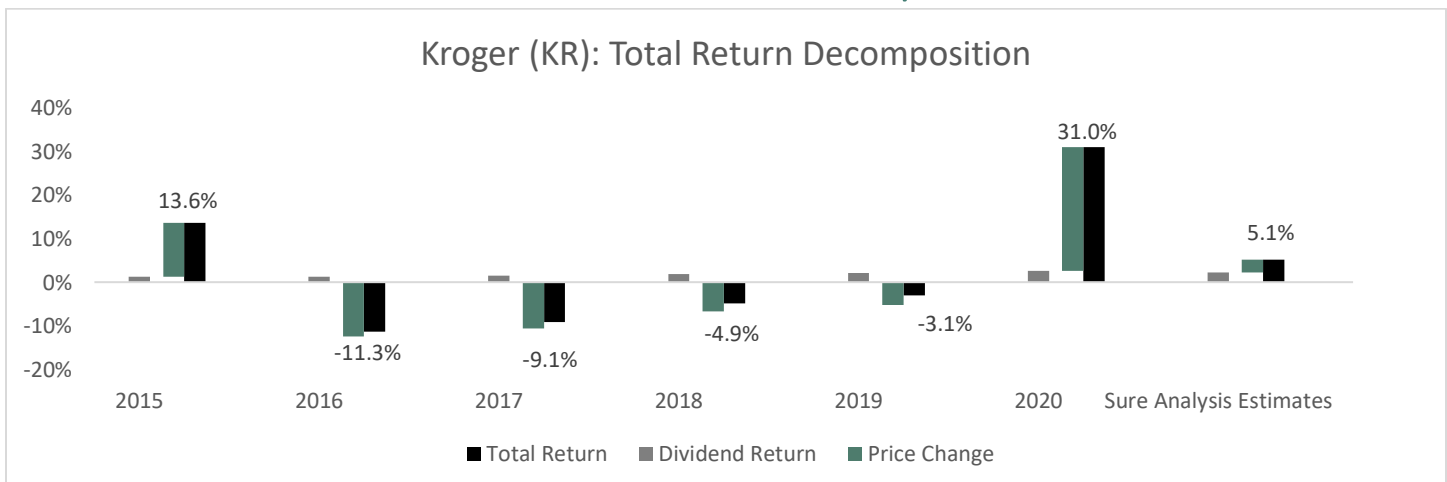
Kroger has been prudent about its dividend, with a payout ratio sticking around the 20% to 30% range. The larger capital return focus has been, and likely will continue to be, on share repurchases. We believe this is prudent considering the competitive landscape of Kroger's industry.

At the end of quarter Kroger held \$360 million in cash, \$12.5 billion in current assets (54% of which is inventory) and \$48.8 billion in total assets against \$15.2 billion in current liabilities and \$39.6 billion in total liabilities. Long-term debt stood at \$13.0 billion against underlying earnings power of about \$2.3 billion.

Final Thoughts & Recommendation

Shares are up 14% 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 5.1% annual returns, stemming from 3% growth and a 1.9% 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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