



The Kroger Co. (KR)

Updated September 10th, 2021, by Eli Inkrot

Key Metrics

| | | | | | |
|-----------------------------|------|--|------|---|----------|
| Current Price: | \$42 | 5 Year CAGR Estimate: | 4.4% | Market Cap: | \$31 B |
| Fair Value Price: | \$43 | 5 Year Growth Estimate: | 2.0% | Ex-Dividend Date¹: | 11/12/21 |
| % Fair Value: | 99% | 5 Year Valuation Multiple Estimate: | 0.3% | Dividend Payment Date¹: | 12/01/21 |
| Dividend Yield: | 2.0% | 5 Year Price Target | \$47 | Years Of Dividend Growth: | 16 |
| Dividend Risk Score: | A | Retirement Suitability Score: | B | Last Dividend Increase: | 16.7% |

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 \$31 billion company serves nearly 11 million customers a day.

On June 24th, 2021, Kroger increased its quarterly dividend by 16.7% to \$0.21.

On September 10th, 2021, Kroger reported Q2 fiscal year results for the period ending August 14th, 2021. (Kroger's fiscal year ends the Saturday closest January 31st.) For the quarter Kroger reported \$31.68 billion in sales, up 3.9% compared to Q2 2020. However, excluding fuel, sales were down -0.4%. Digital sales were up 114% compared to two years ago, as this segment continues to be an important part of the business. Adjusted earnings-per-share equaled \$0.80 compared to \$0.73 in Q2 2020.

Kroger also updated its fiscal 2021 guidance. The company now expects identical sales declining -1.5% to -1.0% (from a decline of -4.0% to -2.5%) and adjusted earnings-per-share of \$3.25 to \$3.35 (from \$2.95 to \$3.10 and \$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.

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 | \$3.30 | \$3.64 |
| DPS | \$0.22 | \$0.27 | \$0.32 | \$0.35 | \$0.41 | \$0.47 | \$0.50 | \$0.55 | \$0.60 | \$0.68 | \$0.84 | \$1.18 |
| Shares² | 1,122 | 1,028 | 1,016 | 974 | 967 | 924 | 870 | 798 | 788 | 758 | 745 | 690 |

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 \$3.30 in earnings-per-share this year to go along with a 2% intermediate-term growth rate. Even so, this still implies much improved expectations from prior to the pandemic.

¹ Estimate

² In millions.

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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 | 12.8 | 13.0 |
| Avg. Yld. | 1.9% | 2.2% | 1.7% | 1.4% | 1.1% | 1.3% | 1.9% | 2.0% | 2.4% | 2.1% | 2.0% | 2.5% |

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% | 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 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.

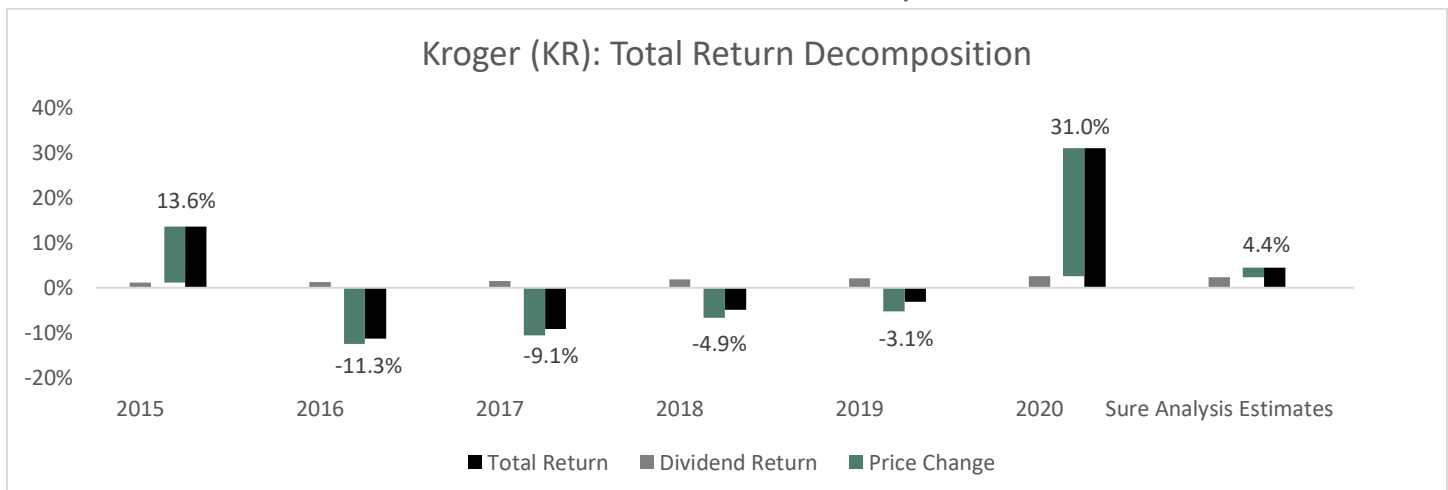
Kroger has been prudent about its dividend, with a payout ratio sticking around the 20% to 30% range. The larger capital return focus has been, and likely will continue to be, on share repurchases. We believe this is prudent considering the competitive landscape of Kroger's industry.

At the end of quarter Kroger held \$339 million in cash, \$12.3 billion in current assets (53% of which is inventory) and \$48.5 billion in total assets against \$15.6 billion in current liabilities and \$39.2 billion in total liabilities. Long-term debt stood at \$12.6 billion.

Final Thoughts & Recommendation

Shares are up 24% since our September 2020 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 4.4% annual returns, stemming from 2% growth and a 2.0% 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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