The Kroger Co. (KR)

Updated December 4th, 2022 by Quinn Mohammed

Key Metrics

Current Price:	$48	**5 Year CAGR Estimate:**	7.5%	**Market Cap:**	$35 B
Fair Value Price:	$53	**5 Year Growth Estimate:**	3.0%	**Ex-Dividend Date[1]:**	02/14/23
% Fair Value:	89%	**5 Year Valuation Multiple Estimate:**	2.3%	**Dividend Payment Date[1]:**	03/01/23
Dividend Yield:	2.2%	**5 Year Price Target**	$62	**Years Of Dividend Growth:**	17
Dividend Risk Score:	A	**Retirement Suitability Score:**	B	**Rating:**	Hold

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, along with fuel centers, pharmacies, and jewelry stores in 35 states. The $35 billion company serves about 11 million customers a day.

On October 14th, 2022, Kroger announced that it had entered into a definitive merger agreement with Albertsons Companies, Inc. (NYSE: ACI). Kroger will purchase all of Albertsons' outstanding shares at $34.10 per share, for a total value of roughly $24.6 billion.

On December 1st, Kroger reported third quarter results for the period ending November 5th, 2022. (Kroger's fiscal year ends the Saturday closest January 31st.) For the quarter, Kroger reported $34.2 billion in sales, up 7.3% compared to 2021. Excluding fuel, sales increased 6.4% compared to the year ago period. Adjusted earnings-per-share equaled $0.88 compared to $0.78 in 3Q21.

Kroger's share repurchase program was put on pause, as the company prioritizes de-leveraging in large part due to the proposed merger with Albertsons.

Kroger also raised fiscal 2022 guidance. The company expects identical sales growth without fuel to be in the range of 5.1% to 5.3% (up from 4.0% to 4.5%) and adjusted earnings-per-share of $4.05 to $4.15 (up from $3.95 to $4.05).

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$1.32	$1.43	$1.76	$2.06	$2.12	$2.04	$2.11	$2.19	$3.47	$3.68	***$4.10***	***$4.75***
DPS	$0.27	$0.32	$0.35	$0.41	$0.47	$0.50	$0.55	$0.60	$0.68	$0.78	***$1.04***	***$1.46***
Shares[2]	1,028	1,016	974	967	924	870	798	788	758	754	***730.0***	***680.0***

In the 2008 through 2019 period Kroger grew its earnings-per-share by a 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 2020, growth was more difficult to achieve.

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. In 2021, Kroger built on this momentum, earning record results. 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.

Kroger expects to continue building on the momentum generated in 2020 and 2021, as they optimize technology and innovation in the quest to build competitive advantages. We are estimating $4.10 in earnings-per-share this year to go along with a 3% intermediate-term growth rate. Even so, this still implies much improved expectations from prior to the

[1] Estimate
[2] In millions.

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pandemic. The announced merger with Albertsons' is also a major catalyst, as this will see the combined company operating more than 4,996 stores, 66 distribution centers, 52 manufacturing plants, 3,972 pharmacies and 2,015 fuel centers. This behemoth of a corporation would operate across 48 states and the District of Columbia.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	9.1	12.9	14.5	18.2	16.4	12.8	13.2	11.6	9.4	10.6	***11.6***	***13.0***
Avg. Yld.	2.2%	1.7%	1.4%	1.1%	1.3%	1.9%	2.0%	2.4%	2.1%	1.9%	***2.2%***	***2.4%***

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 at 11.6 times expected earnings, this implies the potential for a valuation tailwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	20%	22%	20%	20%	22%	25%	26%	27%	20%	21%	***25%***	***31%***

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.

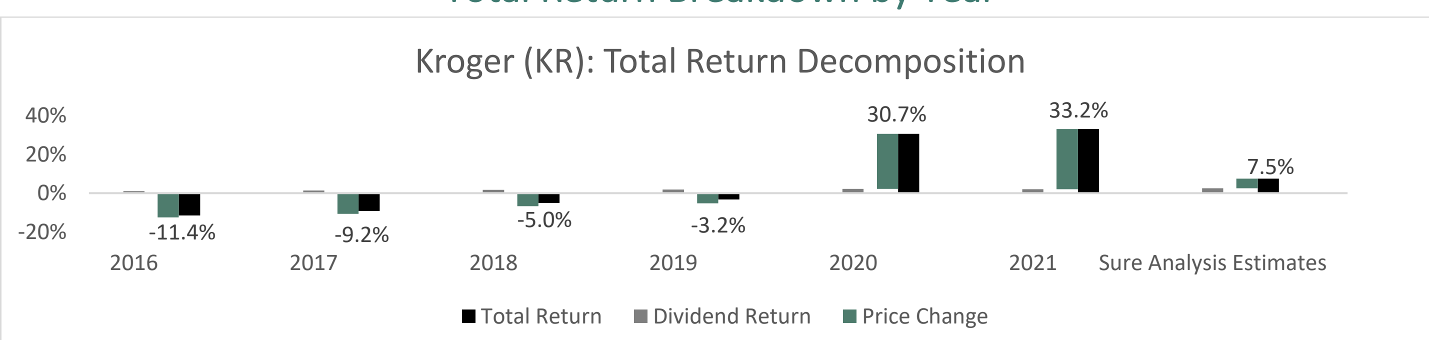
Kroger has been prudent about its dividend, with a payout ratio sticking around the 20% to 30% range. The larger capital return focus has been, and likely will continue to be, on share repurchases. We believe this is prudent considering the competitive landscape of Kroger's industry.

At the end of quarter Kroger held $241 million in cash, $13.4 billion in current assets (65% of which is inventory) and $50.0 billion in total assets against $17.7 billion in current liabilities and $40.0 billion in total liabilities. Long-term debt stood at $12.4 billion.

Final Thoughts & Recommendation

Shares are up 5% year-to-date, which compares favorably to the -15% year-to-date decline of the S&P 500. Kroger has proved to be a strong and resilient business, but the industry is not getting any easier, although results improved dramatically amid the pandemic. We forecast the potential for 7.5% annual total returns, stemming from 3.0% growth, a 2.2% starting yield, and a valuation tailwind. Shares earn a hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue ($B)	90.27	96.62	98.38	108.47	109.83	115.34	123.28	121.85	122.29	132.50
Gross Profit	18,880	19,893	20,237	22,953	24,334	25,835	27,469	26,749	26,992	30,901
Gross Margin	20.9%	20.6%	20.6%	21.2%	22.2%	22.4%	22.3%	22.0%	22.1%	23.3%
SG&A Exp.	15,964	15,477	15,809	17,868	18,669	20,043	22,421	21,670	22,092	25,374
D&A Exp.	1,638	1,652	1,703	1,948	2,089	2,340	2,436	2,465	3,289	3,373
Operating Profit	1,278	2,764	2,725	3,137	3,576	3,452	2,612	2,614	2,251	2,780
Op. Margin	1.4%	2.9%	2.8%	2.9%	3.3%	3.0%	2.1%	2.1%	1.8%	2.1%
Net Profit	602	1,497	1,519	1,728	2,039	1975	1,907	3,110	1,659	2,585
Net Margin	0.7%	1.5%	1.5%	1.6%	1.9%	1.7%	1.5%	2.6%	1.4%	2.0%
Free Cash Flow	760	892	1,243	1,384	1,568	573	604	1,197	1,536	3,950
Income Tax	247	794	751	902	1,045	957	-405	900	469	782

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	23,476	24,634	29,281	30,497	33,897	36,505	37,197	38,118	45,256	48,662
Cash & Equivalents	188	238	401	268	277	322	347	429	399	1,687
Acc. Receivable	949	1,051	1,116	1,266	1,734	1,649	1,637	1,589	1,706	1,781
Inventories	5,114	5,146	5,651	5,688	6,168	6,561	6,533	6,846	7,084	7,063
Goodwill & Int.	1,138	1,364	2,837	3,061	3,777	4,184	4,025	4,345	4,142	4,073
Total Liabilities	19,510	20,420	23,886	25,055	27,099	29,795	30,292	30,283	36,683	39,112
Accounts Payable	4,329	4,484	4,881	5,052	5,728	5,818	5,858	6,059	6,349	6,679
Long-Term Debt	8,165	8,879	11,310	11,597	12,079	14,077	15,589	14,351	13,256	12,410
Total Equity	3,981	4,207	5,384	5,412	6,820	6,698	6,931	7,886	8,602	9,576
LTD/E Ratio	2.05	2.11	2.10	2.14	1.77	2.10	2.25	1.82	1.54	1.30

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	2.6%	6.2%	5.6%	5.8%	6.3%	5.6%	5.2%	8.3%	4.0%	5.5%
Return on Equity	13.0%	36.6%	31.7%	32.0%	33.3%	29.2%	28.0%	42.0%	20.1%	28.4%
ROIC	4.8%	11.9%	10.2%	10.2%	11.4%	10.0%	8.8%	13.9%	7.5%	11.8%
Shares Out.	1,028	1,016	974	967	924	870	798	788	758	754
Revenue/Share	76.11	89.96	94.59	109.23	112.07	120.39	136.37	148.96	151.91	169.65
FCF/Share	0.64	0.83	1.20	1.39	1.60	0.60	0.67	1.46	1.91	5.06

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