



# Foot Locker Inc. (FL)

Updated May 24<sup>th</sup>, 2023, by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$27	<b>5 Year CAGR Estimate:</b>	5.8%	<b>Market Cap:</b>	\$2.5 B
<b>Fair Value Price:</b>	\$18	<b>5 Year Growth Estimate:</b>	8.0%	<b>Ex-Dividend Date:</b>	07/13/23
<b>% Fair Value:</b>	150%	<b>5 Year Valuation Multiple Estimate:</b>	-7.8%	<b>Dividend Payment Date:</b>	07/28/23
<b>Dividend Yield:</b>	5.9%	<b>5 Year Price Target</b>	\$26	<b>Years Of Dividend Growth:</b>	2
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	D	<b>Rating:</b>	Hold

## Overview & Current Events

Foot Locker was established in 1974 as part of the FW Woolworth Company and became independent in 1988. The company has outlived its former parent, which closed in 1997. The athletic apparel retailer, known for its namesake Foot Locker brand, operates nearly 3,000 stores in 27 countries. Foot Locker is a \$2.5 billion market capitalization company that should generate about \$8 billion in revenue this year.

Foot Locker posted first quarter earnings on May 19<sup>th</sup>, 2023, and results were much worse than expected, including very weak guidance. The stock plunged by more than a third following the report.

Adjusted earnings-per-share came to 70 cents, which was 8 cents under estimates. In addition, revenue was \$1.93 billion, down 12% year-over-year, and missing estimates by \$60 million. Comparable sales plummeted 9.1% year-over-year, which included pressure from macroeconomic headwinds, lower income tax refunds, and changing vendor mix.

Gross margin declined by 400 basis points due to promotional activity, as well as increased theft cost. Inventory also soared 25% year-over-year to \$1.76 billion, implying there is likely to be more margin weakness in the quarters ahead.

Sales guidance was cut to a decline of 6.5% to 8% this year, in addition to adjusted earnings-per-share of \$2.00 to \$2.25, a sharp cut from the prior range of \$3.35 to \$3.65. We've reduced our estimate accordingly to \$2.00 on fears of greater margin weakness.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>EPS</b>	\$2.89	\$3.61	\$3.84	\$4.82	\$3.99	\$4.71	\$4.93	\$2.81	\$7.77	\$4.95	<b>\$2.00</b>	<b>\$2.94</b>
<b>DPS</b>	\$0.78	\$0.88	\$1.00	\$1.10	\$1.24	\$1.38	\$1.49	\$0.93	\$0.85	\$1.50	<b>\$1.60</b>	<b>\$2.04</b>
<b>Shares<sup>1</sup></b>	146	140	137	132	120	113	105	105	100	95	<b>90</b>	<b>80</b>

During the Great Recession, Foot Locker's earnings dipped ~20%, but since then they had sharply rebounded prior to 2020. From 2008 through 2018 the company was able to increase earnings-per-share by over 20% annually. However, this was during a time when Foot Locker's net profit margin improved from ~2% to ~7% and the share count was reduced by -25%. Moving forward we are more cautious, albeit still optimistic, on the firm's growth prospects. We note growth in 2019 was much slower, and of course, was negative for 2020. We've left our growth estimate unchanged given the base of earnings for 2023 is now at a decade-plus low.

Share repurchases were restarted in Q3 of 2020, so we see the stock as having that tailwind once again moving forward, although management has been quite cautious thus far spending on repurchases. That said, the new repurchase authorization combined with the massive decline in the share price should see heavy buying in the coming quarters. We're moving our growth estimate to 8% annually given the guidance suggested by management, as well as the low base of earnings that the company is beginning 2023 with. The company has rationalized its store base and inventory position, which is helping margins, and comparable sales have been okay, although a decline is expected for this year. The primary risks after Q1 results are weak comparable sales and bloated inventory levels.

<sup>1</sup> 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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## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	12.3	14.0	16.9	13.4	13.0	11.3	9.7	11.6	6.9	7.6	13.5	9.0
Avg. Yld.	2.2%	1.7%	1.5%	1.7%	2.4%	2.6%	3.1%	2.9%	1.6%	4.0%	5.9%	7.7%

Over the past decade, shares of Foot Locker have traded hands with an average P/E ratio of about 14 times earnings. The valuation is now higher after Q1 results, and the low earnings guidance for this year. Given the stock is at 13.5 times earnings and our fair value estimate is 9, we see a headwind to total returns from the valuation. The stock is yielding 5.9% today.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	28%	24%	26%	23%	31%	29%	30%	33%	11%	30%	80%	70%

Foot Locker's competitive advantage is in its valuable brand names, its decades of experience in athletic apparel retailing and its sizable scale. Moreover, Foot Locker's balance sheet affords the company enormous financial stability, which it is using to buy back shares.

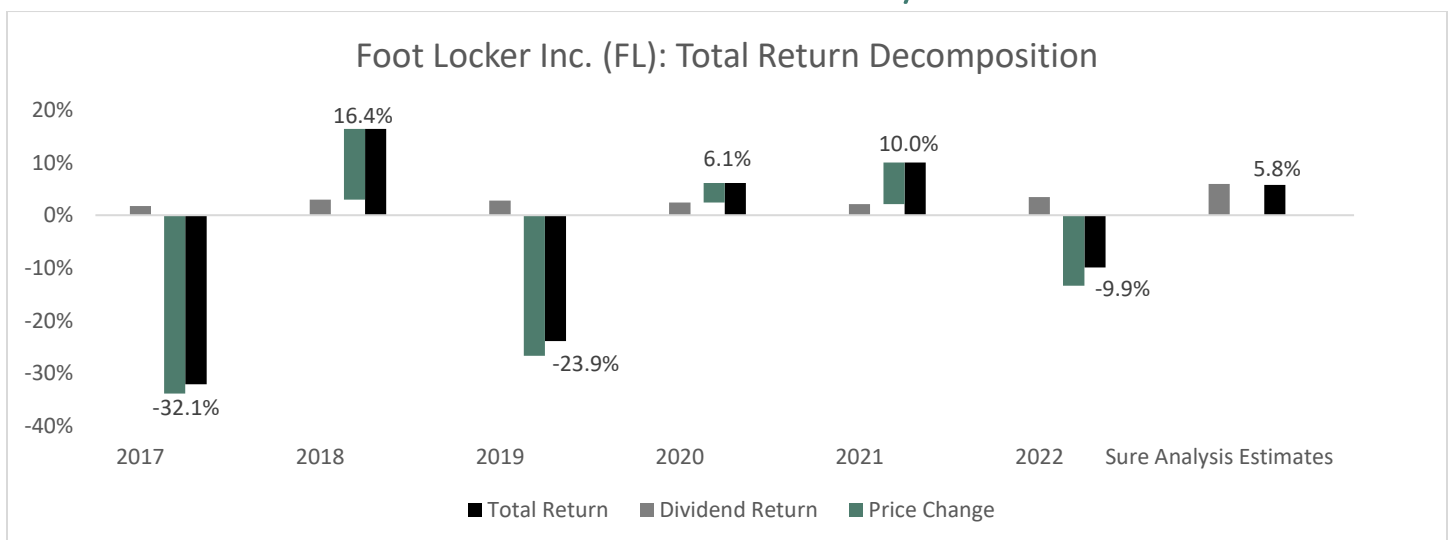
This does not mean that earnings will not deteriorate in tougher times. During the Great Recession, Foot Locker posted earnings-per-share of \$0.67, \$0.54, and \$1.10 through the 2008 to 2010 stretch, while the dividend was held steady. This gives a fair indication of the company's ability to withstand tougher times and bounce back. However, the dividend was suspended and reinstated at a lower rate in 2020.

The new dividend is now elevated against earnings, but management seems to think the margin issues the company has are temporary given high inventory levels. We note that should earnings rise, the dividend should be in a better place in the quarters to come.

## Final Thoughts & Recommendation

We now have serious concerns with Foot Locker's fundamentals following the guidance cut in Q1. With a yield of 5.9%, offset by the 7.8% headwind from the valuation and 8% growth, we are reiterating Foot Locker at a hold rating with 5.8% estimated annual returns, but note that volatility is likely to continue until the inventory situation improves.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Revenue</b>	6,505	7,151	7,412	7,766	7,782	7,939	8,005	7,548	8,958	8,759
<b>Gross Profit</b>	2,133	2,374	2,505	2,636	2,456	2,528	2,543	2,183	3,080	2,804
<b>Gross Margin</b>	32.8%	33.2%	33.8%	33.9%	31.6%	31.8%	31.8%	28.9%	34.4%	32.0%
<b>SG&amp;A Exp.</b>	1,334	1,426	1,415	1,472	1,501	1,614	1,654	1,587	1,851	1,903
<b>D&amp;A Exp.</b>	133	139	148	158	173	178	179	176	197	---
<b>Operating Profit</b>	666	809	942	1,006	782	736	710	420	1,032	693
<b>Operating Margin</b>	10.2%	11.3%	12.7%	13.0%	10.0%	9.3%	8.9%	5.6%	11.5%	21.7%
<b>Net Profit</b>	429	520	541	664	284	541	491	323	893	342
<b>Net Margin</b>	6.6%	7.3%	7.3%	8.6%	3.6%	6.8%	6.1%	4.3%	10.0%	3.9%
<b>Free Cash Flow</b>	324	522	563	578	539	594	509	903	457	---
<b>Income Tax</b>	234	289	296	340	294	172	181	171	348	180

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Total Assets</b>	3,487	3,577	3,775	3,840	3,961	3,820	6,589	7,041	8,135	7,907
<b>Cash &amp; Equivalents</b>	858	967	1,021	1,046	849	891	907	1,680	804	536
<b>Accounts Receivable</b>	99	78	94	101	106	87	100	124	134	---
<b>Inventories</b>	1,220	1,250	1,285	1,307	1,278	1,269	1,208	923	1,266	1,643
<b>Goodwill &amp; Int. Ass.</b>	230	206	201	197	206	181	176	176	1,251	1,211
<b>Total Liabilities</b>	991	1,081	1,222	1,130	1,442	1,314	4,116	4,265	4,892	4,614
<b>Accounts Payable</b>	263	301	279	249	258	387	333	400	596	492
<b>Long-Term Debt</b>	136	132	129	127	125	124	122	110	457	452
<b>Shareholder's Equity</b>	2,496	2,496	2,553	2,710	2,519	2,506	2,473	2,776	3,239	3,293
<b>LTD/E Ratio</b>	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.04	0.14	0.14

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
<b>Return on Assets</b>	12.5%	14.7%	14.7%	17.4%	7.3%	13.9%	9.6%	4.7%	11.8%	4.3%
<b>Return on Equity</b>	17.6%	20.8%	21.4%	25.2%	10.9%	21.5%	20.0%	12.3%	29.7%	10.5%
<b>ROIC</b>	16.7%	19.8%	20.4%	24.1%	10.4%	20.5%	19.0%	11.8%	27.1%	9.2%
<b>Shares Out.</b>	146	140	137	132	120	113	105	105	104	96
<b>Revenue/Share</b>	43.22	48.98	52.64	57.48	60.84	68.38	73.37	71.82	86.30	91.72
<b>FCF/Share</b>	2.15	3.58	4.00	4.28	4.21	5.12	4.67	8.59	4.40	---

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

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