



The Kroger Co. (KR)

Updated December 11th, 2023 by Quinn Mohammed

Key Metrics

Current Price:	\$45	5 Year CAGR Estimate:	10.3%	Market Cap:	\$32 B
Fair Value Price:	\$57	5 Year Growth Estimate:	3.0%	Ex-Dividend Date¹:	02/14/24
% Fair Value:	79%	5 Year Valuation Multiple Estimate:	4.9%	Dividend Payment Date¹:	03/01/24
Dividend Yield:	2.6%	5 Year Price Target	\$66	Years Of Dividend Growth:	17
Dividend Risk Score:	A	Retirement Suitability Score:	B	Rating:	Buy

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 \$32 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. In an effort to garner the necessary approvals and ease regulators, Kroger and Albertsons announced a divestiture plan in which it will sell 413 stores, 8 distribution centers, 2 offices, and 5 private label brands to C&S Wholesale Grocers, LLC for roughly \$1.9 billion.

On November 30th, 2023, Kroger reported third quarter 2023 results for the period ending November 4th, 2023. (Kroger's fiscal year ends the Saturday closest January 31st.) For the quarter, Kroger reported \$34.0 billion in sales, down 0.6% compared to Q3 2022. Excluding fuel, sales decreased 0.5% compared to the year ago period. Adjusted earnings-per-share equaled \$0.95 compared to \$0.88 in 2Q22.

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

Kroger updated fiscal 2023 guidance. The company expects identical sales growth without fuel to be in the range of 0.6% to 1.0% and adjusted earnings-per-share of \$4.50 to \$4.60.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$1.43	\$1.76	\$2.06	\$2.12	\$2.04	\$2.11	\$2.19	\$3.47	\$3.68	\$4.23	\$4.55	\$5.27
DPS	\$0.32	\$0.35	\$0.41	\$0.47	\$0.50	\$0.55	\$0.60	\$0.68	\$0.78	\$0.94	\$1.16	\$1.63
Shares²	1,016	974	967	924	870	798	788	758	726	716	719	680

In the 2008 through 2019 period, Kroger grew its earnings-per-share at 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 and 2022, Kroger built on this momentum, earning record results. In 2022, in particular, the company executed their Leading with Fresh and Accelerating with Digital strategies platforms, increasing delivery sales.

The company has reduced its share count by 4% over the last decade and digital sales continue to be strong.

We are estimating \$4.55 in earnings-per-share this year to go along with a 3.0% intermediate-term growth rate.

¹ Estimate

² In millions.

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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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	12.9	14.5	18.2	16.4	12.8	13.2	11.6	9.4	10.6	11.6	9.8	12.5
Avg. Yld.	1.7%	1.4%	1.1%	1.3%	1.9%	2.0%	2.4%	2.1%	1.9%	1.7%	2.6%	2.5%

During the last decade, shares of Kroger have traded hands with an average P/E ratio of about 13 times earnings. We peg fair value at just below this mark. With shares trading at 9.8 times expected earnings, this implies the potential for a valuation tailwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	22%	20%	20%	22%	25%	26%	27%	20%	21%	22%	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, between 1% and 3%, which allows it to keep competitors at bay but also means that the stock is extremely sensitive to competitive pricing pressures.

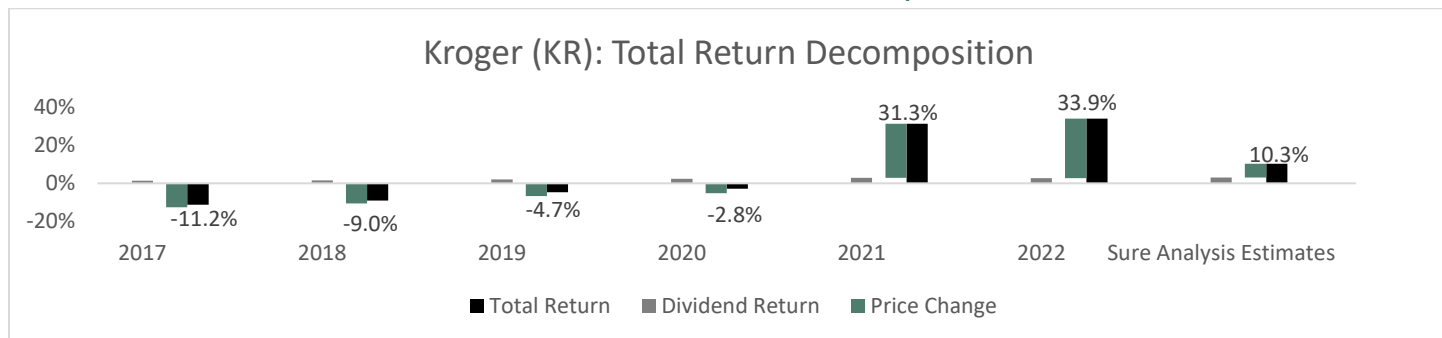
Kroger has been prudent about its dividend, with a payout ratio sticking around the 20% to 30% range. The larger capital return focus has been, and likely will continue to be, on share repurchases. We believe this is prudent considering the competitive landscape of Kroger's industry.

At the end of quarter, Kroger held \$251 million in cash, \$13.4 billion in current assets (59% of which is inventory) and \$51.0 billion in total assets against \$16.8 billion in current liabilities and \$39.8 billion in total liabilities. Long-term debt stood at \$12.0 billion.

Final Thoughts & Recommendation

Shares have declined by nearly 4% in the last one year, which compares unfavorably to the 16% gain of the S&P 500. Kroger has proved to be a strong and resilient business, and results improved dramatically amid the pandemic. We forecast the potential for 10.3% annual total returns, stemming from 3.0% growth, a 2.6% starting yield, and a valuation tailwind. Shares earn a buy rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue (\$B)	96.62	98.38	108.47	109.83	115.34	123.28	121.85	122.29	132.50	137.89
Gross Profit	19,893	20,237	22,953	24,334	25,835	27,469	26,749	26,992	30,901	30,349
Gross Margin	20.6%	20.6%	21.2%	22.2%	22.4%	22.3%	22.0%	22.1%	23.3%	22.0%
SG&A Exp.	15,477	15,809	17,868	18,669	20,043	22,421	21,670	22,092	25,374	24,048
D&A Exp.	1,652	1,703	1,948	2,089	2,340	2,436	2,465	3,289	3,373	3,429
Operating Profit	2,764	2,725	3,137	3,576	3,452	2,612	2,614	2,251	2,780	3,477
Op. Margin	2.9%	2.8%	2.9%	3.3%	3.0%	2.1%	2.1%	1.8%	2.1%	2.5%
Net Profit	1,497	1,519	1,728	2,039	1,975	1,907	3,110	1,659	2,585	1,655
Net Margin	1.5%	1.5%	1.6%	1.9%	1.7%	1.5%	2.6%	1.4%	2.0%	1.2%
Free Cash Flow	892	1,243	1,384	1,568	573	604	1,197	1,536	3,950	3,576
Income Tax	794	751	902	1,045	957	-405	900	469	782	385

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	24,634	29,281	30,497	33,897	36,505	37,197	38,118	45,256	48,662	49,086
Cash & Equivalents	238	401	268	277	322	347	429	399	1,687	1,821
Acc. Receivable	1,051	1,116	1,266	1,734	1,649	1,637	1,589	1,706	1,781	1,828
Inventories	5,146	5,651	5,688	6,168	6,561	6,533	6,846	7,084	7,063	6,783
Goodwill & Int.	1,364	2,837	3,061	3,777	4,184	4,025	4,345	4,142	4,073	4,018
Total Liabilities	20,420	23,886	25,055	27,099	29,795	30,292	30,283	36,683	39,112	39,657
Accounts Payable	4,484	4,881	5,052	5,728	5,818	5,858	6,059	6,349	6,679	7,117
Long-Term Debt	8,879	11,310	11,597	12,079	14,077	15,589	14,351	13,256	12,410	11,745
Total Equity	4,207	5,384	5,412	6,820	6,698	6,931	7,886	8,602	9,576	9,452
LTD/E Ratio	2.11	2.10	2.14	1.77	2.10	2.25	1.82	1.54	1.30	1.24

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	6.2%	5.6%	5.8%	6.3%	5.6%	5.2%	8.3%	4.0%	5.5%	3.4%
Return on Equity	36.6%	31.7%	32.0%	33.3%	29.2%	28.0%	42.0%	20.1%	28.4%	17.4%
ROIC	11.9%	10.2%	10.2%	11.4%	10.0%	8.8%	13.9%	7.5%	11.8%	7.7%
Shares Out.	1,016	974	967	924	870	798	788	758	754	754
Revenue/Share	89.96	94.59	109.23	112.07	120.39	136.37	148.96	151.91	169.65	182.88
FCF/Share	0.83	1.20	1.39	1.60	0.60	0.67	1.46	1.91	5.06	4.74

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

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