



The Kroger Co. (KR)

Updated June 25th, 2024 by Quinn Mohammed

Key Metrics

Current Price:	\$50	5 Year CAGR Estimate:	7.3%	Market Cap:	\$36B
Fair Value Price:	\$55	5 Year Growth Estimate:	3.0%	Ex-Dividend Date¹:	08/14/24
% Fair Value:	91%	5 Year Valuation Multiple Estimate:	2.0%	Dividend Payment Date¹:	09/02/24
Dividend Yield:	2.3%	5 Year Price Target	\$64	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 \$36 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 579 stores to C&S Wholesale Grocers, LLC for roughly \$2.9 billion. This transaction includes the sale of QFC, Mariano's, Carrs, and Haggen banners to C&S, as well as the private label brands Debi Lilly Design, Primo Taglio, Open Nature, ReadyMeals, and Waterfront Bistro.

In February 2024, the FTC sued to block the proposed merger, and a trial has been set for August 2024.

On June 20th, 2024, Kroger reported first quarter 2024 results for the period ending May 25th, 2024. (Kroger's fiscal year ends the Saturday closest January 31st.) For the quarter, Kroger reported \$45.3 billion in sales, up just 0.2% compared to Q1 2023. Excluding fuel, sales increased 0.6% compared to the year ago period. Adjusted earnings-per-share equaled \$1.43 compared to \$1.51 in 1Q23.

Kroger reaffirmed its fiscal 2024 guidance. The company expects identical sales growth without fuel to be in the range of 0.25% to 1.75% and adjusted earnings-per-share of \$4.30 to \$4.50.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$1.76	\$2.06	\$2.12	\$2.04	\$2.11	\$2.19	\$3.47	\$3.68	\$4.23	\$4.76	\$4.40	\$5.10
DPS	\$0.35	\$0.41	\$0.47	\$0.50	\$0.55	\$0.60	\$0.68	\$0.78	\$0.94	\$1.10	\$1.16	\$1.55
Shares²	974	967	924	870	798	788	758	726	716	719	720	690

Kroger faced challenges growing 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, but the company has performed very well since. In the last nine and five years, Kroger increased its EPS at a 12% and 15% CAGR, respectively.

The COVID-19 pandemic, which plagued many businesses, had been a tailwind for groceries, and Kroger in particular. To this point, earnings were significantly higher in 2020, marking a banner year. Since then, Kroger has built on this momentum, earning record results each year. In 2022, in particular, the company executed its Leading with Fresh and Accelerating with Digital strategies platforms, increasing delivery sales.

The company has reduced its share count by 3.3% over the last decade. However, Kroger's share repurchase program was recently put on pause, as the company prioritizes de-leveraging, partly due to the proposed merger with Albertsons.

We are estimating \$4.40 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 nearly 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	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Avg. P/E	14.5	18.2	16.4	12.8	13.2	11.6	9.4	10.6	11.6	9.7	11.3	12.5
Avg. Yld.	1.4%	1.1%	1.3%	1.9%	2.0%	2.4%	2.1%	1.9%	1.8%	2.2%	2.3%	2.4%

During the last decade, shares of Kroger have traded hands with an average P/E ratio of nearly 13 times earnings. We peg fair value at just below this mark. With shares trading at 11.3 times expected earnings, this implies the potential for a moderate valuation tailwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	20%	20%	22%	25%	26%	27%	20%	21%	22%	23%	26%	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 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.

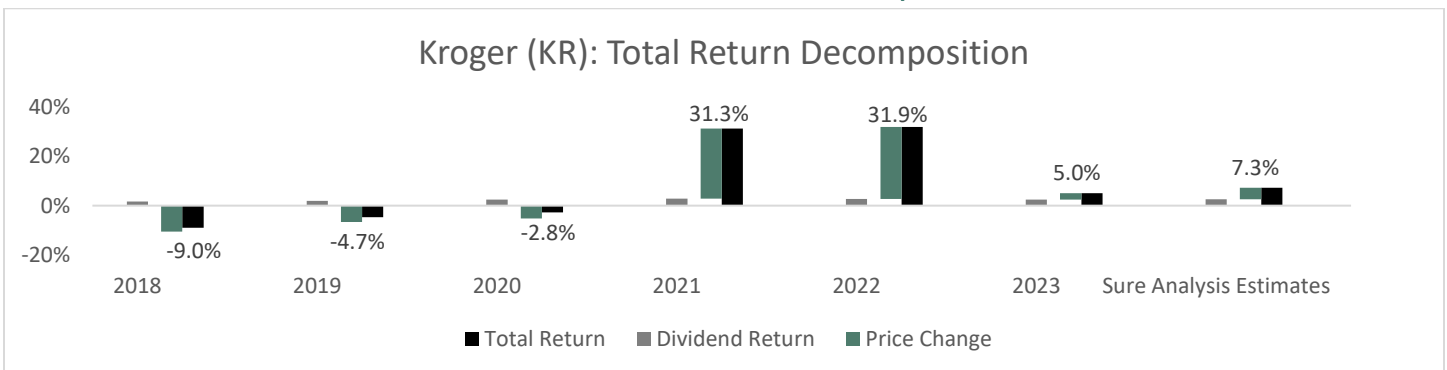
Kroger has been prudent about its dividend, with a payout ratio sticking around the 20% to 30% range. The larger capital return focus has been on share repurchases. We will likely see this ramping up again in the future, but for now, Kroger is focusing on deleveraging. We believe this is prudent considering the competitive landscape of Kroger's industry.

At the end of the most recent quarter, Kroger held \$345 million in cash, \$14.0 billion in current assets (48% of which is inventory) and \$51.4 billion in total assets against \$16.2 billion in current liabilities and \$39.0 billion in total liabilities. Long-term debt stood at \$12.0 billion.

Final Thoughts & Recommendation

Shares of Kroger have increased by 9% year-to-date, which compares unfavorably to the 15% 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 7.3% annual total returns, stemming from 3.0% growth, a 2.3% starting yield, and 2.0% P/E multiple expansion. Kroger maintains its hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue (\$B)	98.38	108.47	109.83	115.34	123.28	121.85	122.29	132.50	137.89	150.04
Gross Profit	20,237	22,953	24,334	25,835	27,469	26,749	26,992	30,901	30,349	33360
Gross Margin	20.6%	21.2%	22.2%	22.4%	22.3%	22.0%	22.1%	23.3%	22.0%	22.2%
SG&A Exp.	15,809	17,868	18,669	20,043	22,421	21,670	22,092	25,374	24,048	861
D&A Exp.	1,703	1,948	2,089	2,340	2,436	2,465	3,289	3,373	3,429	3750
Operating Profit	2,725	3,137	3,576	3,452	2,612	2,614	2,251	2,780	3,477	3126
Op. Margin	2.8%	2.9%	3.3%	3.0%	2.1%	2.1%	1.8%	2.1%	2.5%	2.1%
Net Profit	1,519	1,728	2,039	1,975	1,907	3,110	1,659	2,585	1,655	2164
Net Margin	1.5%	1.6%	1.9%	1.7%	1.5%	2.6%	1.4%	2.0%	1.2%	1.4%
Free Cash Flow	1,243	1,384	1,568	573	604	1,197	1,536	3,950	3,576	2884
Income Tax	751	902	1,045	957	-405	900	469	782	385	667

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	29,281	30,497	33,897	36,505	37,197	38,118	45,256	48,662	49,086	50520
Cash & Equivalents	401	268	277	322	347	429	399	1,687	1,821	1883
Acc. Receivable	1,116	1,266	1,734	1,649	1,637	1,589	1,706	1,781	1,828	2136
Inventories	5,651	5,688	6,168	6,561	6,533	6,846	7,084	7,063	6,783	7105
Goodwill & Int.	2,837	3,061	3,777	4,184	4,025	4,345	4,142	4,073	4,018	3815
Total Liabilities	23,886	25,055	27,099	29,795	30,292	30,283	36,683	39,112	39,657	38920
Accounts Payable	4,881	5,052	5,728	5,818	5,858	6,059	6,349	6,679	7,117	10400
Long-Term Debt	11,310	11,597	12,079	14,077	15,589	14,351	13,256	12,410	11,745	12230
Total Equity	5,384	5,412	6,820	6,698	6,931	7,886	8,602	9,576	9,452	11600
LTD/E Ratio	2.10	2.14	1.77	2.10	2.25	1.82	1.54	1.30	1.24	1.05

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	5.6%	5.8%	6.3%	5.6%	5.2%	8.3%	4.0%	5.5%	3.4%	4.3%
Return on Equity	31.7%	32.0%	33.3%	29.2%	28.0%	42.0%	20.1%	28.4%	17.4%	20.0%
ROIC	10.2%	10.2%	11.4%	10.0%	8.8%	13.9%	7.5%	11.8%	7.7%	9.6%
Shares Out.	974	967	924	870	798	788	758	754	754	725
Revenue/Share	94.59	109.23	112.07	120.39	136.37	148.96	151.91	169.65	182.88	206.95
FCF/Share	1.20	1.39	1.60	0.60	0.67	1.46	1.91	5.06	4.74	3.98

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

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