



The Kroger Co. (KR)

Updated September 24th, 2024 by Quinn Mohammed

Key Metrics

| | | | | | |
|-----------------------------|------|--|-------|---|----------|
| Current Price: | \$56 | 5 Year CAGR Estimate: | 5.0% | Market Cap: | \$41 B |
| Fair Value Price: | \$55 | 5 Year Growth Estimate: | 3.0% | Ex-Dividend Date¹: | 11/15/24 |
| % Fair Value: | 102% | 5 Year Valuation Multiple Estimate: | -0.4% | Dividend Payment Date¹: | 12/01/24 |
| 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 \$41 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. The FTC's preliminary injunction hearing began in late August and ended on September 17th. In-house hearings will start on October 1st if the injunction is issued.

On September 12th, 2024, Kroger reported second quarter 2024 results for the period ending August 17th, 2024. (Kroger's fiscal year ends the Saturday closest January 31st.) For the quarter, Kroger reported \$33.9 billion in sales, flat compared to Q2 2023. Excluding fuel, sales increased 1.3% compared to the year ago period. Adjusted earnings-per-share equaled \$0.93 compared to \$0.96 in 2Q23.

Kroger updated its fiscal 2024 guidance. The company now expects identical sales growth without fuel to be in the range of 0.75% to 1.75% (from 0.25% to 1.75% previously), but still expects 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 | \$1.28 | \$1.71 |
| Shares² | 974 | 967 | 924 | 870 | 798 | 788 | 758 | 726 | 716 | 719 | 725 | 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.

¹ Estimate

² In millions.

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We are estimating \$4.40 in earnings-per-share this year to go along with a 3.0% intermediate-term growth rate.

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 | 12.7 | 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% | 2.7% |

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 12.7 times expected earnings, this implies a small negative change in the valuation from here.

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% | 29% | 34% |

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.

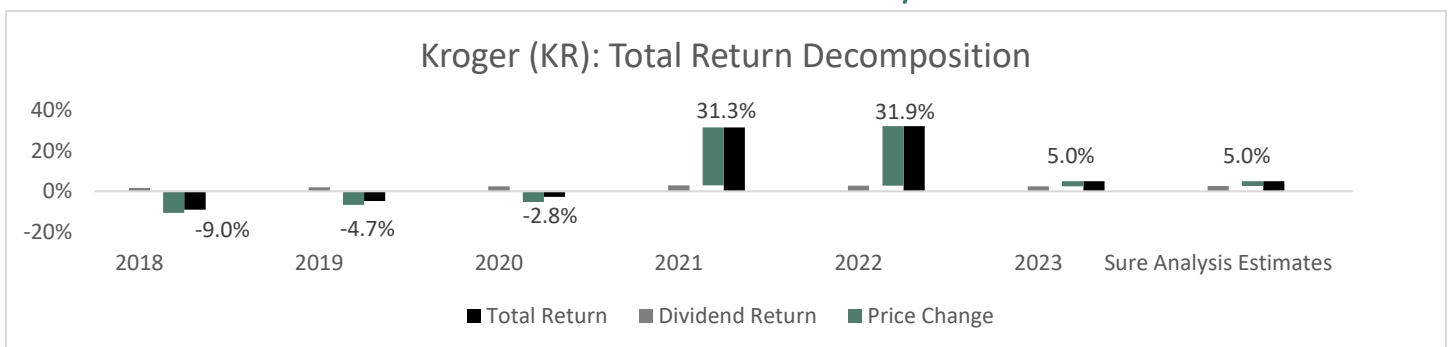
Kroger has been prudent about its dividend, with a payout ratio sticking around the 20% to 30% range. The larger capital return focus has been on share repurchases. We will likely see this ramping up again in the future, but for now, Kroger is focusing on deleveraging. We believe this is prudent considering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

At the end of the most recent quarter, Kroger held \$233 million in cash, \$14.1 billion in current assets (47% of which is inventory) and \$51.4 billion in total assets against \$16.1 billion in current liabilities and \$38.9 billion in total liabilities. Long-term debt stood at \$12.0 billion.

Final Thoughts & Recommendation

Shares of Kroger have increased by 23% year-to-date, beating the 20% 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 5.0% annual total returns, stemming from 3.0% growth, and a 2.3% starting yield, partly offset by -0.4% P/E multiple contraction. 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 | 1975 | 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.

Disclaimer

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