

Kroger Stock Analysis

Kroger doesn't need much introduction as it is the second grocer by sales in the US.

Who are the top 10 Grocers in the United States?

1. WALMART INC. Grocery Sales: \$288 billion from 4,253 stores. ...
2. THE **KROGER CO.** Revenues of about \$121 billion across its 2,759 stores operating under the **Kroger**, Harris Tweeter and Smith's banners.
3. **ALBERTSONS COS. INC.** ...
4. AHOLD DELHAIZE USA. ...
5. PUBLIX SUPER MARKETS INC. ...
6. H.E. ...
7. MEIJER INC. ...
8. WAKEFERN FOOD CORP.

US grocers list – Source: [Food Industry](#)

Revenues (1) have been flat over the last years if we exclude the recent COVID boom. Margins (2) and net income have been volatile but what the company did well is buybacks that lowered the number of shares outstanding from 1.27 billion to the current 790 million (5), consequently pushed earnings per share higher (3) and dividends (4) too.

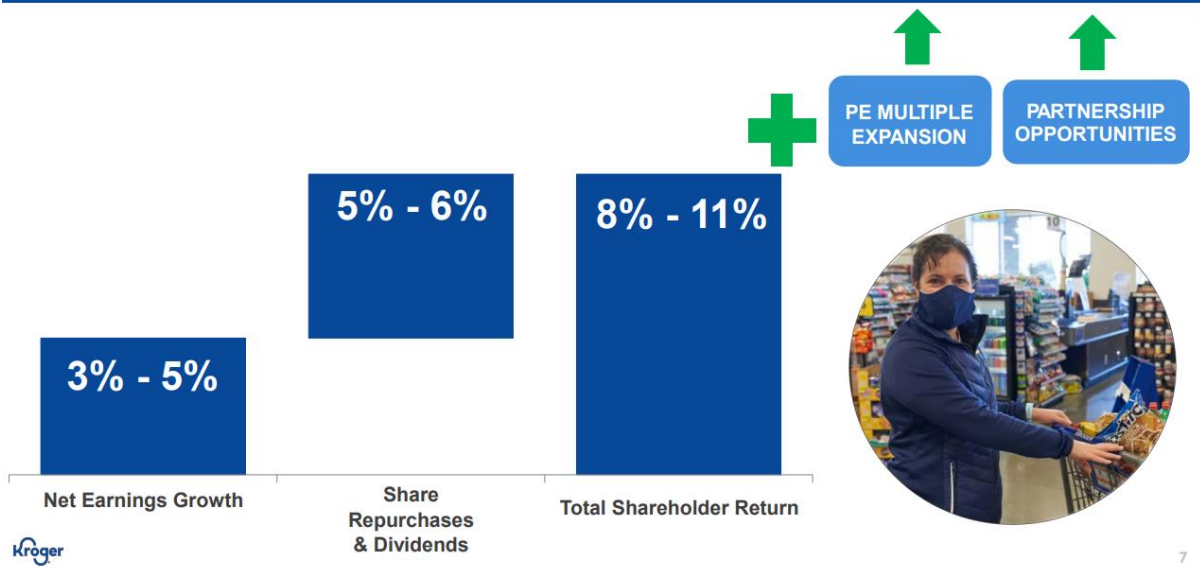
The Kroger Co KR ★★★												Morningstar ETFInvestor Free Download.	
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Quote Chart Stock Analysis Performance Key Ratios Financials Valuation Insiders Ownership Filings Bonds													
Financials												Export	Ascending
	2011-01	2012-01	2013-01	2014-01	2015-01	2016-01	2017-01	2018-01	2019-01	2020-01	TTM		
Revenue USD Mil	82,189	90,374	96,751	98,375	108,465	109,830	115,337	122,662	121,162	122,286	130,654		
Gross Margin %	22.2	20.9	20.6	20.6	21.2	22.2	22.4	22.0	21.7	22.1	23.1		
Operating Income USD Mil	2,200	1,278	2,764	2,725	3,137	3,576	3,436	2,085	2,614	2,251	3,475		
Operating Margin %	2.7	1.4	2.9	2.8	2.9	3.3	3.0	1.7	2.2	1.8	2.7		
Net Income USD Mil	1,116	602	1,497	1,519	1,728	2,039	1,975	1,907	3,110	1,659	2,989		
Earnings Per Share USD	0.87	0.51	1.39	1.45	1.72	2.06	2.05	2.09	3.76	2.04	3.75		
Dividends USD	0.20	0.21	0.25	0.31	0.34	0.40	0.45	0.49	0.53	0.60	0.66		
Payout Ratio % *	22.4	42.6	32.8	20.2	20.5	18.9	20.9	28.9	11.7	29.4	17.6		
Shares Mil	1,276	1,186	1,074	1,040	993	980	958	904	818	805	790		
Book Value Per Share * USD	4.27	3.55	3.63	4.82	5.46	6.49	7.16	7.07	9.59	11.14	13.23		
Operating Cash Flow USD Mil	3,366	2,658	2,833	3,380	4,163	4,833	4,272	3,413	4,164	4,664	6,513		
Cap Spending USD Mil	-1,919	-1,898	-2,062	-2,330	-2,831	-3,349	-3,699	-2,809	-2,967	-3,128	-2,827		
Free Cash Flow USD Mil	1,447	760	771	1,050	1,332	1,484	573	604	1,197	1,536	3,686		
Free Cash Flow Per Share * USD	1.13	0.64	0.50	1.06	1.31	1.27	0.62	1.15	1.39	1.74	—		
Working Capital USD Mil	-449	-1,780	-3,098	-1,875	-2,492	-3,079	-2,520	-3,080	-3,471	-3,353	—		

* Indicates calendar year-end data information

Kroger stock analysis – financials – Source: [Morningstar](#)

The plan is to keep doing buybacks and dividends alongside trying to grow earnings naturally, hopefully reaching low single digits growth.

Remain Committed to Generating Consistently Strong and Attractive TSR



Kroger's total shareholder return target – Source: [Kroger's investor day presentation 2020](#)

By being the second largest grocer Kroger is leveraging on its economies of scale and therefore taking advantage as much as possible from private labels, data, rewards, marketing, logistics, partnerships (Ocado and Walgreens) to increase its margins and lower costs.

Our Competitive Moats Are Strong

Fresh	Our Brands	Data & Personalization	Seamless Ecosystem
Winning the Customer	Most Loved Brands	Unmatched Rewards	Customer Reach

Kroger

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Kroger's improvement focus – Source: [Kroger's investor day presentation 2020](#)

The goal is to create costs savings of \$1 billion.



Building Momentum

Kroger	2018 Actual	2019 Actual	2020 Targets ⁽³⁾
ID Sales w/o Fuel	+1.8%	+2.0%	>13.0%
Cost Savings	>\$1B	>\$1B	\$1B
Alt. Profit Growth ⁽¹⁾	Beat Goal	>\$100M	~ \$100M
Operating Profit ⁽²⁾	\$2.9B	\$3.0B	\$3.9-\$4.0B
EPS ⁽²⁾	\$2.11	\$2.19	\$3.20-\$3.30

1. Incremental net operating profit | 2. Adjusted FIFO operating profit & adjusted EPS | 3. 2020 numbers are without adjusted items, if applicable, and identical sales guidance is without fuel.

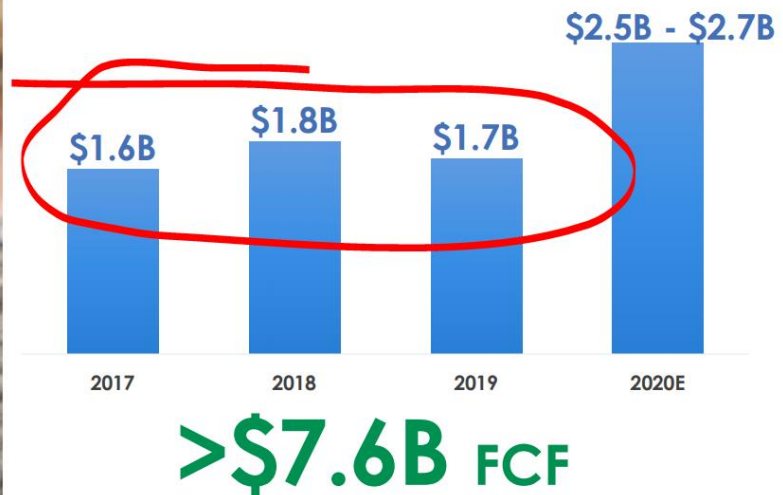
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Kroger's financials – Source: [Kroger's investor day presentation 2020](#)

Free cash flows have been improved thanks to the COVID boosted demand but even prior to COVID, free cash flows were strong. At \$1.7 billion the free cash flow yield is at 7% given the current market capitalization of \$24 billion.



Consistently Generating Strong Free Cash Flow



Adjusted Free Cash Flow = Operating Cash Flow (before company-sponsored pension contributions) – Capital Expenditures and excluding the cash tax-effect of the sale of strategic assets.

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Kroger's free cash flows – Source: [Kroger's investor day presentation 2020](#)

All the free cash flows are returned to shareholders through either dividends or buybacks.

Disciplined Approach to Financial Management



Kroger's dividends and buybacks – Source: [Kroger's investor day presentation 2020](#)

Kroger's current business situation – comments on last conference call

One of the best ways to understand the situation a business is in or a stock is to listen to the last conference call. The management tells their story but the analysts' questions always offer the key insights exposing the main issues and worries. My comments on the last conference are the following.”

Managements' introduction:

- Digital is profitable and growing, private label is growing fast too,
- Ocado partnership, building fulfilment centres,
- Pension liabilities are an issue - \$1 billion charge coming or \$0.98 per share, healthcare costs are also a factor.
- “During the quarter, Kroger repurchased \$304 million of shares under its \$1 billion Board authorization announced on September 11, 2020. Year-to-date, Kroger has now repurchased \$989 million of shares. In June, Kroger increased the dividend by 13%, marking the 14th consecutive year of dividend increases.”

Questions topics:

- E-commerce reflection in P&L? Answer: Management is excited about it and positive for future growth – doesn't share any specifics,
- Gross margin COVID benefits of 2020 declining in 2021? Answer: Some headwinds surely but management is working on underlying fundamental improvements constantly,
- Online pharmacy industry development? Kroger's answer is multichannel and combining healthy foods with pharmacy requirements (smart I must say), plus they say “it appears that about half of healthcare costs are driven by the way people eat”,

- Inflation in supply chain, from corn to freight? Management seeing 2% inflation running at the moment where they aren't impacted and can transfer prices to customers,
- From whom are you taking market share? Smaller players, big? Answer: just seeing the customer spend more at Kroger's, very broad-based market share comment.

Kroger stock valuation

I have made a valuation using a 2% growth rate for Kroger over the next 10 years and using the free cash flows as basis. Their plan is to use the money to do buybacks so I haven't included the buyback induced EPS growth into the model because I have included the cash flows are rewards for shareholders. Buyback returns will depend on the stock price at which Kroger does its buybacks so it is something difficult to model.

KROGER												Terminal Value	Growth rate		
Scenario 1 normal case	Cashflow	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2030	2%	next 5 years	
		1.53	1.56	1.59	1.62	1.66	1.69	1.72	1.76	1.79	1.83	26.89	2%	5 to 10 years	
	PV(10%)	1.39	1.29	1.20	1.11	1.03	0.95	0.88	0.82	0.76	0.70	10.37	10%	Discount rate	
	INTRINSIC VALUE												20.50	15.0	Terminal multiple
Scenario 2 best case in EUR	Cashflow	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2030	3%	next 5 years	
		1.55	1.59	1.64	1.69	1.74	1.77	1.81	1.85	1.88	1.92	37.65	2%	5 to 10 years	
	PV(10%)	1.40	1.32	1.23	1.15	1.08	1.00	0.93	0.86	0.80	0.74	14.51	10%	Discount rate	
	Present value sum												25.03	20.0	Terminal multiple
Scenario 3 worst case in EUR	Cashflow	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2030	0%	next 5 years	
		1.50	1.50	1.50	1.50	1.50	1.47	1.44	1.41	1.38	1.36	13.84	-2%	5 to 10 years	
	PV(10%)	1.36	1.24	1.13	1.02	0.93	0.83	0.74	0.66	0.59	0.52	5.33	10%	Discount rate	
	Present value sum												14.36	10.0	Terminal multiple
		Scenario	Probability	PV	Part										
		Scenario 1 (normal case)	0.6	20.50	12.30										
		Scenario 2 (best case)	0.2	25.03	5.01										
		Scenario 3 (worst case)	0.2	14.36	2.87										
				Sum	20.18										

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Kroger stock valuation – Source: Sven Carlin Research Platform (downloadable)

At the current market cap of \$24 billion, Kroger is still likely to deliver a high single digit yearly investment return over time which is really good for a stock in such a safe business environment and working hard on strengthening its foothold.

As for the stock, here goes the investment thesis.

Kroger stock investment thesis

Kroger is a huge business and investment returns will depend on the underlying fundamentals alongside the nuances surrounding the business; from the effects of the Ocado and Walgreens partnerships to the impacts of the pension liabilities costs or union discussions and the general state of the economy.

I am sure there will be periods of bad news and others with good news that will have big impacts on the stock which could make it a very interesting stock to watch around those expectation sensitivities and buy when the sentiment is bad but the fundamentals remain ok.

One of my first [YouTube videos was on Kroger stock](#) where I discussed how the market is irrational when assessing Kroger because it is too focused on short-term issues and not on the long-term investing fundamentals.

I made the video after the June 2017 stock drop while Buffett bought a billion of Kroger when the stock dropped again in 2019.



Kroger stock market irrationality

I think that by following Kroger, one could get to really good returns by simply following the natural cycles in the grocery sector. We have to eat so the underlying fundamentals are stable, but we have to compare the real value to the market's sentiment.

The following excerpt from my stock watch list shows how Kroger is cheaper than Ahold Delhaize but a bit more expensive than Sprouts Farmers Market. I will follow it over time and consider adding to my portfolio if we have situations like 2017 or 2019, but this doesn't mean it is not a good stock to own now, just that I have better.

4	Kroger	KR	24.36	20.18	0.83	12-Jan-21	WATCH	USD Billions	Good business, safe industry, good return in the high single digits, great for swi
5	Sprouts F	SFM	2.38	2.19	0.92	12-Jan-21	WATCH	USD Billions	Good business, focused on growth but with declining operating margins which i
6	AHOLD	AMS:AD	26.68	20.23	0.76	14-Jan-21	WATCH	EUR Billions	Good business, BOL.COM is high growth, high cash flows, but typical retail risks

Excerpt from my watch list – SFM and Kroger look cheaper than Ahold – Source: Research Platform