

The Kroger Co.(KR)

\$33.47 (As of 03/05/20)

Price Target (6-12 Months): **\$35.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 03/11/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: A

Momentum: B

Summary

Shares of Kroger have risen and outpaced the industry in the past six months. Notably, the company's Restock Kroger program, investment in the grocery space and focus on margin-rich alternative profit streams is setting the stage right. The company is expanding store base, introducing new items, digital coupons, and order online, pick up in store initiative. It also remains committed to improve identical supermarket sales. A reflection of these endeavors was visible in fourth-quarter fiscal 2019 results. The company's identical sales, excluding fuel, grew 2% during the quarter. Kroger envisions identical store sales growth, excluding fuel, to be greater than 2.25% in fiscal 2020. Certainly, management remains committed to augment sales and improve margins. However, industry-wide lower gross margin rates in pharmacy are a concern.

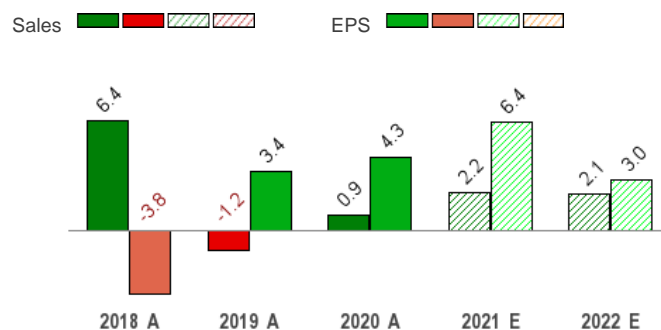
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$33.70 - \$20.70
20 Day Average Volume (sh)	8,397,974
Market Cap	\$26.8 B
YTD Price Change	15.5%
Beta	0.54
Dividend / Div Yld	\$0.64 / 1.9%
Industry	Retail - Supermarkets
Zacks Industry Rank	Top 45% (114 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.8%
Last Sales Surprise	0.0%
EPS F1 Est- 4 week change	0.3%
Expected Report Date	06/18/2020
Earnings ESP	-0.3%
P/E TTM	15.2
P/E F1	14.3
PEG F1	1.9
P/S TTM	0.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022					127,662 E
2021	38,321 E	28,829 E	28,626 E	29,679 E	125,030 E
2020	37,251 A	28,168 A	27,974 A	28,893 A	122,286 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022					\$2.41 E
2021	\$0.80 E	\$0.44 E	\$0.50 E	\$0.58 E	\$2.34 E
2020	\$0.72 A	\$0.44 A	\$0.47 A	\$0.57 A	\$2.20 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/05/2020. The reports text is as of 03/06/2020.

Overview

The Kroger Co. (KR), which operates in the thin-margin grocery industry, has been undergoing a complete makeover, not only with respect to products but also in terms of the way consumers prefer shopping grocery. The company is launching plant-based products as well as eyeing technological expansion. It acquired meal kit company Home Chef and partnered with British online grocery delivery firm Ocado that reinforces its position in the online ordering, automated fulfillment and home delivery space. It has also introduced grocery delivery service Kroger Ship and inked a deal with driverless car company Nuro.

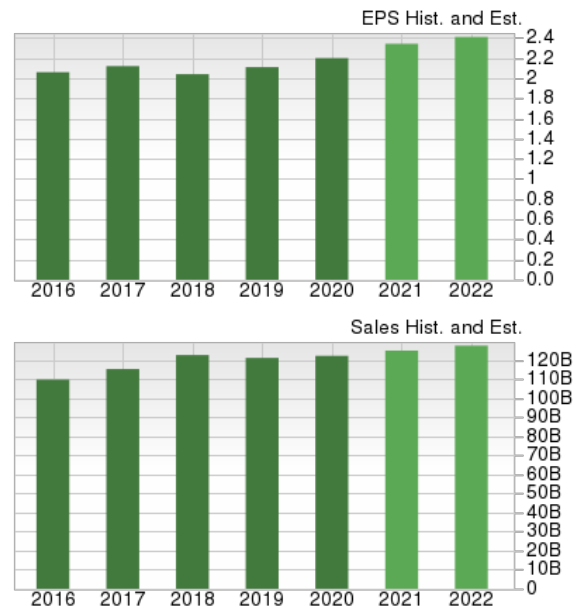
The Cincinnati, Ohio-based company operates 2,764 retail food stores under banners including Kroger, City Market, Dillons, Food 4 Less, Fred Meyer, Fry's, Harris Teeter, Jay C, King Soopers, Mariano's, Pick 'n Save, QFC, Ralphs and Smith's. Out of these, 2,270 are pharmacies and 1,537 are fuel centers. Further, it also manufactures and processes certain food products that are sold in its supermarkets.

Kroger's supermarket and multi-department stores operate under four formats combo stores (combination of food and drug stores), multi-department stores, marketplace stores, and price impact warehouses. The combo stores include natural food and organic sections, pharmacies, general merchandise, and pet centers, as well as offer perishables items such as fresh seafood and organic produce.

The multi-department stores offer a collection of general merchandise products such as apparel, home fashion and furnishings, electronics, automotive products, toys, and fine jewelry. The marketplace stores include full-service grocery and pharmacy departments and a general merchandise area that includes outdoor living products, electronics, home goods, and toys.

The combo stores, multi department stores, and marketplace stores also have fuel centers. The price impact warehouse offers grocery, health, and beauty care items.

Additionally, the company operates 37 food production plants, mainly bakeries and dairies. These supply roughly 32% of Our Brands units and 43% of the grocery category Our Brands units sold in its supermarkets; the remaining Our Brands items are produced by other manufacturers.



Reasons To Buy:

▲ **Strategic Endeavors Drive Stock:** A dominant position among the nation's largest grocery retailers enables Kroger to boost market share by introducing new items such as plant-based products, digital coupons, order online pick up in store and smart shopping lists. The company's Customer 1st strategy enriches the consumers shopping experience and convinces them of returning to the store. The company is also looking to expand its "Scan, Bag, Pay & Go and Self-CheckOut" program. We note that digital sales surged 22% during the fourth quarter of fiscal 2020, while pickup or delivery reached 97% of Kroger households. The company has been narrowing its non-grocery footprint and making investments to expand its grocery offerings as well as e-commerce presence. The company has launched Kroger Pay, a mobile payment app. Also, it has rolled out the Kroger REWARDS debit card — a rewarding payment service. Additionally, the company partnered with Microsoft to enhance customers' shopping experience through data driven technology and is aggressively working toward more convenient grocery delivery options.

A dominant position among the nation's largest grocery retailers enables Kroger to boost its market share by expanding store base, introducing new items and digital coupons.

Management is also targeting "margin-rich alternative profit streams" such as Kroger Personal Finance, Media, and Customer Data Insights, which contributed more than \$100 million in operating profit in fiscal 2019. Kroger and Lindsay Goldberg have come together to form PearlRock Partners, a platform that will identify, invest and groom next generation of leading consumer product brands. The platform is a part of Kroger's alternative profit streams portfolio. Such robust initiatives have been aiding the stock that came out with decent fourth-quarter fiscal 2019 results, wherein both the top and bottom line grew year over year. Notably, the stock has gained 33% in the past six months, outpacing the industry's growth of 1.2%.

▲ **Major Buyouts & Partnership:** Management continues to deploy capital to concentrate more on remodels, merchandising, and other viable projects to overcome competition in the grocery space. The industry is undergoing a fundamental change with technology playing a key role as focus shifts to online shopping. In this regard, Kroger acquired meal kit provider Home Chef. The company also expanded its Home Chef Express meal kits nationwide. The company is testing new Home Chef retail meal solutions, comprising oven-ready options, Heat & Eat choices, and lunch kits. This apart, the company partnered with British online grocery delivery company Ocado that reinforces its position in the online ordering, automated fulfillment and home delivery space. Kroger is aggressively working toward more convenient grocery delivery options. In this regard, the company has started using Nuro's fully autonomous, driverless vehicles for grocery delivery services. In order to further strengthen its digital operations, Kroger joined forces with Alibaba to launch "Our Brands" through the latter's Tmall platform. Also, the company has entered into a partnership with Walgreens to explore new ways to reach consumers. Kroger in association with ClusterTruck, is introducing an on-demand meal delivery service namely Kroger Delivery Kitchen. Customers will get freshly prepared meals in half an hour of ordering, without shelling out a penny for delivery. Kroger's other strategic acquisitions includes Vitacost.com, an online retailer of vitamins and health-oriented products; and Harris Teeter, a grocery chain. The company also acquired Roundy's, the grocery store operator.

▲ **"Restock Kroger" Program:** The company's "Restock Kroger" program is reaping results. Kroger commenced "We Are Local" campaign; new restaurant concept, Kitchen 1883; and added product lines under "Our Brands". During fiscal 2019, "Our Brands" sales exceed \$23.1 billion. The company also introduced 758 Our Brands items during the fiscal year. The company also introduced 39 new Our Brands Plant-Based products in 2019. Under the program, the company is also passing the benefit of cost containment to customers by lowering prices. The company attained more than \$1 billion of cost savings in fiscal 2019 and expects to achieve another \$1 billion savings in fiscal 2020. As a part of the program, the company is making investments in space optimization, store remodels and technology advancements. The company also launched a grocery delivery service "Kroger Ship". The company is making an incremental investment in associates — wages, training and development, customers and infrastructure.

▲ **Optimistic View for Fiscal 2020 & Beyond:** Driven by the success of the "Restock Kroger" program and strong financial model, Kroger retained strong profit forecast for fiscal 2020. The company expects fiscal 2020 adjusted earnings between \$2.30 and \$2.40 per share, higher than fiscal 2019 earnings of \$2.19. It also anticipates identical store sales growth of greater than 2.25%. Further, it estimates generating incremental operating profit growth of \$125-\$150 billion from alternative profit businesses. Moreover, it remains committed to returning cash to shareholders through share repurchases between \$500 million and \$1 billion in fiscal 2020. Management remains on track to attain more than \$1 billion of cost savings in fiscal 2020. It also targets total shareholder returns of 8-11% beyond fiscal 2020, driven by 3-5% earnings growth as well as robust free cash flow. The company's optimistic view for fiscal 2020 and beyond indicates strong top and bottom line growth in the years ahead.

Reasons To Sell:

- ▼ **Gross Margin Contraction:** We note that during the fourth quarter of fiscal 2019, gross margin contracted 30 basis points to 22.1%. FIFO gross margin, excluding fuel, expanded a meagre 6 basis points from the year-ago period on account of improvement in costs of goods and accelerating alternative profit streams, partly offset by investments in price and personalization and continued industry-wide lower gross margin rates in pharmacy. Pharmacy related gross margin challenges are expected to continue. Further, industry experts cited that volatile fuel costs and incremental investments may keep margins under pressure.
- ▼ **Intense Competition & Promotional Activities:** Stiff competition, volatility in food prices and an aggressive promotional environment are the primary headwinds with which Kroger is encountering. The grocery business is highly competitive and fragmented, and Kroger faces intense competition from big players such as Amazon, Walmart and Safeway, other conventional retailers and specialty gourmet retailers with respect to price, store expansion and promotional activities. This may dent the company's sales and margins.
- ▼ **Macroeconomic Volatility:** Kroger's performance remains vulnerable to volatile economic conditions. Being a consumer-driven company, the results are likely to be impacted by factors affecting consumer spending and consumer confidence. To this end, unfavorable changes in employment levels, credit availability, housing market scenario, interest and tax rates, and general business conditions, among others, may hurt consumer spending.
- ▼ **Failure to Renegotiate Contracts:** Most of Kroger's employees are protected by approximately 300 collective bargaining agreements with the unions. Should the company fail to renegotiate new contracts on their expiration with the unions, it could lead to work stoppages and operational disruptions. Kroger contributes to various pension plans arising under collective bargaining agreements. The unfunded nature of these plans could also lower its debt rating.

The grocery business is highly competitive and fragmented, and Kroger faces stiff competition from big players. Also, volatile fuel prices and promotional environment are making things tough.

Last Earnings Report

Kroger's Q4 Earnings Beat Estimates, Increase Y-o-Y

After witnessing a negative earnings surprise in the third quarter of fiscal 2019, The Kroger Co. reported a beat in the fourth quarter. The company posted adjusted earnings of 57 cents a share that came a penny ahead of the Zacks Consensus Estimate and increased 18.8% from the prior-year quarter. The company continues to envision fiscal 2020 earnings between \$2.30 and \$2.40 per share, which indicates an increase from adjusted earnings of \$2.19 reported in fiscal 2019.

Total sales of \$28.89 billion almost came in line with the Zacks Consensus Estimate, following a miss in the preceding two quarters. The metric increased 2.1% from the prior-year quarter.

Excluding fuel and dispositions, top line improved 2.3% from the year-ago period. The company's digital sales surged 22%, while identical sales, excluding fuel, grew 2%. Management forecast identical sales, excluding fuel, to be above 2.25% in fiscal 2020.

We note that gross margin contracted 30 basis points to 22.1%. FIFO gross margin, excluding fuel, expanded 6 basis points from the year-ago period on account of improvement in costs of goods and accelerating alternative profit streams, partly offset by investments in price and personalization and continued industry-wide lower gross margin rates in pharmacy. Adjusted FIFO operating profit increased 20.7% to \$758 million. Kroger anticipates adjusted operating profit in the band \$3-\$3.1 billion for fiscal 2020.

Strategic Endeavors

The grocery industry has been undergoing a fundamental change, with technology playing a major role and the focus shifting to online shopping. Kroger has taken stock of the situation and is in the process of giving itself a complete makeover.

The company's "Restock Kroger" program involving investments in omnichannel platform, identifying margin-rich alternative profit streams, merchandise optimization, and lowering of expenses has been gaining traction. The company is expanding store base, introducing new items, digital coupons, and order online, pick up in store initiative.

Management informed that "Our Brands" sales exceed \$23.1 billion. The company also introduced 39 new Our Brands Plant-Based products in 2019. Pickup or Delivery reached 97% of Kroger households (expanded to 1,989 Pickup locations and 2,385 Delivery locations). Management is also targeting "margin-rich alternative profit streams" which contributed more than \$100 million in operating profit this fiscal year versus the prior. Alternative profit streams are anticipated to contribute an incremental \$125-\$150 million in operating profit in fiscal 2020.

Other Financial Aspects

Kroger ended the quarter with cash of \$393 million, total debt of \$14,076 million, and shareowners' equity of \$8,573 million. Net total debt decreased by \$1,141 million over the last four quarters. Kroger returned \$951 million to shareholders in fiscal 2019. The company bought back shares worth \$400 million during the fourth quarter as part of its authorization of \$1 billion. The company forecast free cash flow generation of \$1.6-\$1.8 billion in fiscal 2020. The company expects to make share repurchases of \$500-\$1,000 million in fiscal 2020.

Quarter Ending **01/2020**

Report Date	Mar 05, 2020
Sales Surprise	0.03%
EPS Surprise	1.79%
Quarterly EPS	0.57
Annual EPS (TTM)	2.20

Recent News

Kroger Launches Plant Based Fresh Meat – Jan 8, 2020

Kroger unveiled the launch of its version of vegan meat namely Simple Truth Emerge, which is an expansion of its in-house Simple Truth brand. The new product line will offer fresh burger patties and grinds at better prices and will be available exclusively at Kroger Family of Stores. Keeping in mind consumers' growing preference for meatless substitutes, these products come with 20 grams of pea-based protein per serving and are free of GMOs, dairy, gluten and soy.

Valuation

Kroger shares are up 15.4% in the year-to-date period and nearly 30.7% over the trailing 12-month period. Stocks in the Zacks sub-industry and Zacks Retail-Wholesale sector are down 1.8% and 2.6%, respectively in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 17.8% and 10.1%, respectively.

The S&P 500 index is down 6.4% in the year-to-date period and 8.7% in the past year.

The stock is currently trading at 14.29X forward 12-month earnings, which compares to 21.04X for the Zacks sub-industry, 24.28X for the Zacks sector and 17.3X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.86X and as low as 9.24X, with a 5-year median of 13.31X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$35 price target reflects 15.15X forward 12-month earnings.

The table below shows summary valuation data for KR

Valuation Multiples - KR					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	14.29	21.04	24.28	17.3
	5-Year High	19.86	21.68	26.19	19.34
	5-Year Low	9.24	14.08	19.06	15.18
	5-Year Median	13.31	16.88	23.08	17.44
P/S F12M	Current	0.21	0.49	1	3.19
	5-Year High	0.36	0.49	1.11	3.43
	5-Year Low	0.13	0.31	0.8	2.54
	5-Year Median	0.2	0.4	0.92	3.01
EV/EBITDA TTM	Current	8.38	9.75	14.45	10.93
	5-Year High	10.82	10.52	15.92	12.88
	5-Year Low	5.47	5.87	10.8	8.49
	5-Year Median	7.93	7.18	12.48	10.79

As of 03/05/2020

Industry Analysis Zacks Industry Rank: Top 45% (114 out of 255)



Top Peers

Companhia Brasileira de Distribuicao (CBD)	Neutral
Costco Wholesale Corporation (COST)	Neutral
Carrefour SA (CRRFY)	Neutral
Dollar Tree, Inc. (DLTR)	Neutral
Marks and Spencer Group PLC (MAKSY)	Neutral
Target Corporation (TGT)	Neutral
Tesco PLC (TSCDY)	Neutral
Walmart Inc. (WMT)	Neutral

Industry Comparison Industry: Retail - Supermarkets				Industry Peers		
	KR Neutral	X Industry	S&P 500	COST Neutral	TGT Neutral	WMT Neutral
VGM Score	A	-	-	B	B	C
Market Cap	26.80 B	5.11 B	21.47 B	139.49 B	53.70 B	328.89 B
# of Analysts	9	3	13	10	13	14
Dividend Yield	1.91%	1.85%	2.04%	0.82%	2.49%	1.83%
Value Score	A	-	-	C	B	C
Cash/Price	0.07	0.09	0.05	0.08	0.02	0.03
EV/EBITDA	6.21	6.90	12.81	21.39	9.90	11.38
PEG Ratio	1.84	2.67	1.88	4.78	2.01	4.82
Price/Book (P/B)	3.13	1.16	2.95	8.60	4.65	4.03
Price/Cash Flow (P/CF)	5.28	6.54	11.75	27.12	10.34	13.09
P/E (F1)	13.76	13.09	17.19	36.47	15.49	22.66
Price/Sales (P/S)	0.22	0.26	2.32	0.88	0.69	0.63
Earnings Yield	6.99%	7.61%	5.81%	2.74%	6.45%	4.42%
Debt/Equity	2.17	0.84	0.70	0.47	1.10	0.79
Cash Flow (\$/share)	6.34	2.99	7.01	11.64	10.25	8.85
Growth Score	A	-	-	A	B	B
Hist. EPS Growth (3-5 yrs)	2.54%	1.02%	10.85%	11.29%	7.70%	0.99%
Proj. EPS Growth (F1/F0)	6.46%	7.15%	6.27%	5.71%	7.04%	3.77%
Curr. Cash Flow Growth	20.55%	3.27%	6.07%	14.92%	5.59%	-0.12%
Hist. Cash Flow Growth (3-5 yrs)	5.65%	1.83%	8.52%	10.65%	2.16%	-0.31%
Current Ratio	0.77	0.80	1.23	1.01	0.83	0.79
Debt/Capital	68.50%	48.17%	42.57%	31.75%	52.42%	44.04%
Net Margin	1.36%	1.56%	11.69%	2.39%	4.20%	2.84%
Return on Equity	20.72%	8.91%	16.66%	23.96%	28.66%	18.16%
Sales/Assets	2.73	2.23	0.54	3.38	1.86	2.22
Proj. Sales Growth (F1/F0)	2.24%	0.96%	3.90%	6.86%	3.53%	3.02%
Momentum Score	B	-	-	D	C	D
Daily Price Chg	8.11%	-0.73%	-3.79%	-1.55%	-1.72%	-0.73%
1 Week Price Chg	-7.19%	-8.89%	-12.06%	-12.68%	-11.97%	-9.19%
4 Week Price Chg	19.32%	-1.86%	-10.92%	1.66%	-7.96%	-0.34%
12 Week Price Chg	18.69%	-3.38%	-8.10%	6.19%	-16.90%	-3.21%
52 Week Price Chg	30.69%	-7.43%	4.09%	45.65%	39.12%	18.95%
20 Day Average Volume	8,397,974	102,405	2,483,920	2,915,706	4,774,682	7,836,486
(F1) EPS Est 1 week change	0.31%	0.00%	0.00%	0.05%	0.07%	0.00%
(F1) EPS Est 4 week change	0.31%	-0.24%	-0.06%	0.59%	0.09%	-1.92%
(F1) EPS Est 12 week change	0.96%	1.07%	-0.42%	1.19%	-0.36%	-1.93%
(Q1) EPS Est Mthly Chg	-2.44%	-1.84%	-0.29%	0.39%	-0.27%	-1.24%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	A
Momentum Score	B
VGM Score	A

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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