

**NYSE: FL**

## **Foot Locker Inc.**

52-Week Range: \$17.46 - \$59.00

Current Price: \$23.04

Date of Price: 04/16/20

Market Cap (M): \$2,860.00

Shares O/S (M): 109

Dividend Yield: 7.15%

YTD Return: -42.75%

Price Target: \$28.32

Implied Upside: 22.9%

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## **Company Description**

Foot Locker is a premium brick and mortar retailer whose focus is on footwear. They are an international retail leader as they are renowned in the sneaker and youth culture through its subsidiaries. The company also possesses a dominant presence in the international apparel retail industry by having over 3000 stores located in over 27 countries around the world. Other than footwear, the company also sells clothing, accessories, and equipment under its subsidiaries such as Kids Foot Locker, Champs Sports, Footaction, Runners Point, and Sidestep. As the world becomes digital, Foot Locker capitalizes on its omni-channel networks to bring physical and virtual stores together by using mobile apps and websites to give customers flexibility on where to buy and whether or not they want to ship or pick up from the store. Foot Locker also has partnerships with some of the world's largest athletic brands such as Nike, Jordan, adidas and Puma as well as upcoming fashion brands such as Champion, FILA and Kappa.

The Kids Foot Locker and Ladies Foot Locker are retailers that focus on the youth and young women who have an interest in athletic and street apparel. There are currently over 400 Kids Foot Locker stores scattered across the world in North and South America, Europe and Australia. There are currently 46 Ladies Foot Locker stores that are operating in the U.S.A and in Puerto Rico.

Champs Sports is another notable subsidiary of Foot Locker as it is one of the largest athletic footwear and clothing retailers in North America. Champs offers a variety of clothing and sneakers from the world's top brands. There are over 530 stores in the world with most of them being located in the U.S.A and Canada.

Runners Point and Sidestep are footwear retailers that are primarily located in Europe. They serve as the "European Foot Lockers" by providing customers with a vast range of athletic gear from head-to-toe. There are 81 Runners Point stores and 77 Sidestep stores all located in Europe.

Eastbay is a marketer that is located in the U.S.A that provides athletes starting from high school with sporting equipment ranging from clothes, footwear and accessories. Eastbay is equipped with over 100 professional salespersons all selling to numerous high school coaches and athletic directors, providing quality products and services.

## **Qualitative Analysis**

### **Growth Strategy**

Being in the apparel industry, consumer preferences change quickly and suddenly. For a company to maintain its performance and sustain its profits, its product line must be flexible. Foot Locker's latest strategy involves the youth as it plans on investing in resale giant Goat as well as a footwear design academy, Pensole. By partnering with these brands, Foot Locker is repositioning its brand in consumer minds as something that is more than just footwear. The

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Pensole partnership has already been implemented in Foot Locker's business as they are selling an exclusive Adidas shoe designed by a Pensole-er. Foot Locker also created a new store concept called "Power Stores." These "Power Stores" are going to be hubs that not only promote the latest sneaker culture, but also be a home for enthusiasts. In addition, they will also host gaming services such as Xbox tournaments to attract another segment of customers. Another prominent strategy for Foot Locker's growth is international expansion. In 2019, Foot Locker appointed 2 Chief Executive Officers to 2 different international market segments. Lew Kimble to the Asia Pacific region, and Vijay Talwar to the EMEA region. By spreading the management across the world, the CEO and Chairman, Richard Johnson has more opportunities to focus on core business operations while international markets are being overseen at the same time. Foot Locker's strategy of empowering youth culture will result in a long-lasting positive impression of the company which will help increase customer retention. The international spread of management will increase Foot Locker's international presence, reaching more and more markets that require their services.

### **Competitive Advantage**

Foot Locker is an industry leader that has a dominant position in the retail industry. Since 1974 when Foot Locker was founded, they have formed solid relationships with their suppliers such as Nike, Adidas, Jordan and Puma. By having a beneficial relationship with its suppliers, Foot Locker can obtain the latest models which will help the company keep up with everchanging consumer preferences. Foot Locker also has many subsidiaries such as Foot Action, Champs and Kid's Foot Locker. These brands help Foot Locker accumulate even more market share than its flagship store already does. Due to the large market that this company occupies, it can sell its items for a premium. In terms of competitors, Foot Locker faces competition with its suppliers such as Nike or Adidas. These two competitors are able to produce at a lower cost in comparison with Foot Locker because they are vertically integrated which means that they are able to manufacture their own products. Additionally, these two brands also have several endorsements by the world's top athletes or most popular celebrities which provides massive awareness amongst consumers as well as a positive reputation. However, a distinct advantage that Foot Locker holds is its variety. The company is able to provide customers with a variety of recognized brands all in the same store. Another competitor in the industry is VF Corporation which is a company that has subsidiaries such as Vans, The North Face, and Timberlands. The difference between Foot Locker and VFC is, again, the variety of brands that it can provide. In addition, Foot Locker's culture and target market is different from VFC's. Foot Locker's hip-hop-street culture targets the youth to young adults, the only part of VFC that shares the same target would be Vans and Timberlands. Another distinct advantage that Foot Locker has is the engagement that it has with its customers. Foot Locker's uses of its mobile app to inform and give customers a new way to sign up for sneaker releases or exclusive offers. This function allows Foot Locker to attract and retain numerous customers. Despite the brands that are against Foot Locker, Foot Locker can hold its ground due to the bond it has with its suppliers,

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the variety that it provides and its engagement with its customers through its investment in social and cultural trends.

### **Management**

Foot Locker is comprised of very talented individuals, all of which have several years of experience in this industry. It is because of their combined efforts and talents that Foot Locker can achieve its position in the world today.

Richard Johnson is the CEO and Chairman of the company. He has served as an executive member of Foot Locker since 2003. With all these years in executive positions at Foot Locker, Johnson's understanding of not only the brand but also the mechanics of the industry makes him more than qualified for his position. He was responsible for the international expansion of Foot Locker into Asia which yielded double digit growth immediately.

Lew Kimble, the CEO of Foot Locker Asia Pacific is also an important asset to the company. Kimble started out as a salesperson at Foot Locker and has now become an executive member since. Kimble's competitive spirit and passion for working in the retail industry is a defined factor for Foot Locker's international growth.

Vijay Talwar is the new CEO of Foot Locker EMEA. He joined Foot Locker in 2016 as President of Digital carrying decades of experience with him from working at retail giants such as Sears and Nike. He will be responsible for lending his expertise to increase the productivity and effectiveness of Foot Locker's operations in the EMEA area.

### **External Analysis**

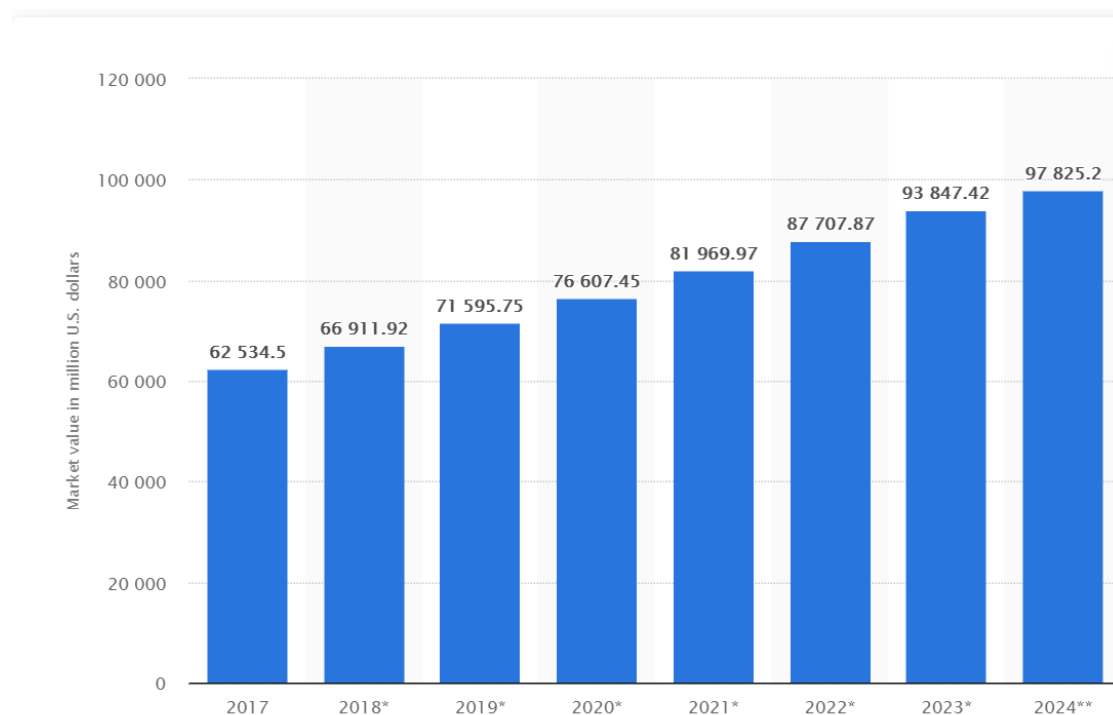
Currently, the entire retail sector is in a slump due to the global COVID-19 pandemic. Foot Locker has closed over 100 stores since the start of the pandemic. Since unemployment is at an all time high, it also means that the overall disposable income of our population will be lower which will reduce the amount of purchases made at non-essential stores such as Foot Locker. Despite the affects of the pandemic, Foot Locker will be able to survive this down period as its EBITDA/interest expense converge ratio is 74.3 which reflects the company's ability to pay its interest expenses with its earnings. Furthermore, the footwear retail industry is also expected to grow at a rate of 3.44% from 2018 to 2023. For a company like Foot Locker who charges a premium on most of its products due to social trends surrounding each product's image, this company's recovery is expected to be slow but sure.

Foot Locker's partnership with Nike allows the company to use technology innovatively to gain profits. Their collaboration will allow customers to view a connected inventory which will be accessible from both the Foot Locker and Nike app. These digital applications also bring other benefits to customers. By using these apps, customers can obtain early access to new sneaker releases as well as chances to unlock limited-edition items. Foot Locker's omnichannel

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approach with delivery start up Deliv will help satisfy customer needs by providing quick and satisfactory delivery times that are comparable with Amazon's. Moreover, Foot Locker also invested over \$130 million in ecommerce start-ups such as GOAT and NTRK as it believes that these investments will help the company enhance customer experience and it resulted in Foot Locker's web sales growing by 12.8%.

A key contributor to Foot Locker's performance as a business is how it uses the current social trend to its advantage. One of the company's key growth strategies is to immerse itself in youth culture, appealing to the younger generation's sense of style. The company must stay updated with "street" fashion trends as well as sports culture as these are the things that the youth indulges in today. In the future, there will be opportunities for Foot Locker as the sneaker industry is expected to grow steadily.

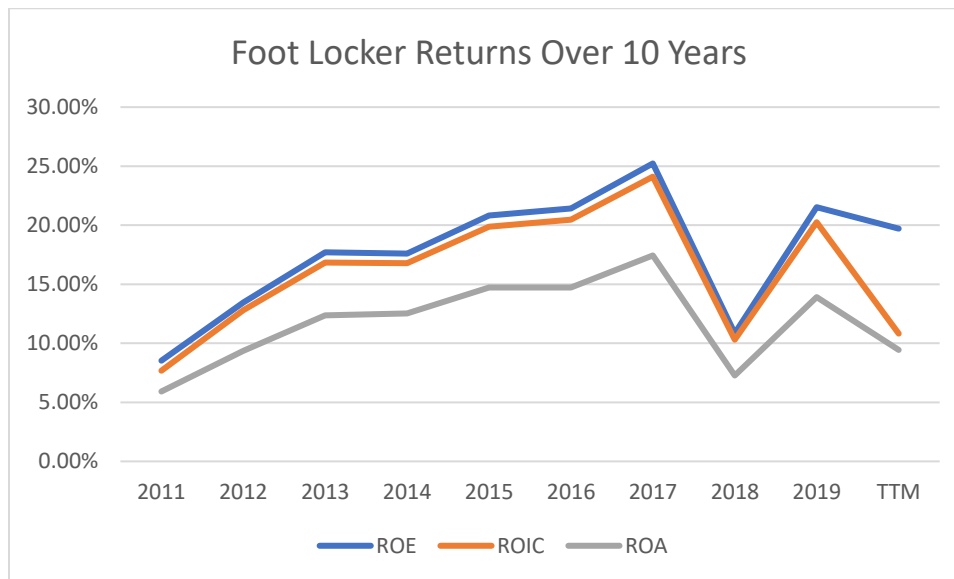


Foot Locker also makes good use of its partnership with sneaker giant Nike by providing customers with signature shoes from NBA's top players. Speaking about the NBA, it is expected that there will be an influx of viewers due to their short hiatus from the pandemic and because it is playoff season. The increase in popularity will drive consumers to purchase items such as sneakers or clothing related to these athletes. The products that Foot Locker sells are a favourite amongst consumers as they can fulfill what they want and need in a shoe. The company's new power stores will also play an important role in enticing new customers and increasing customer retention by reinventing the sneaker shopping experience.

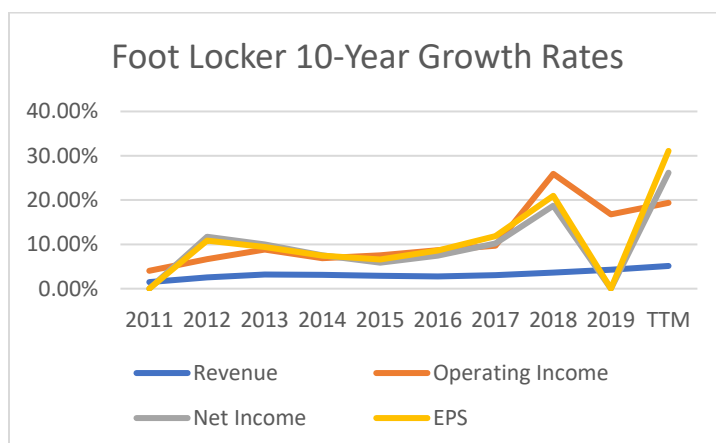
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## Quantitative Analysis

Foot Locker boasts a strong quantitative performance due to its industry leadership and wide economic moat. Due to the current economic situation, the company's returns are lower than average. However, the company operates quite efficiently in the long term with an average ROA of 12.69%, ROE of 19.59% and ROIC of 16.98% across 5 years. Furthermore, the company has been achieving consistent growth in these ratios except for a minor downturn in 2018. This reflects the company's ability to effectively use its assets and equity and make substantial profits from its investments.



Before the pandemic, Foot Locker also displayed positive revenue, operating income, net income, and EPS growth rates of 4.00%, 2.02%, 4.75%, 10.33% respectively across a 5-year average. Furthermore, according to Morningstar's statistics, Foot Locker has been experiencing consistent growth throughout its 10- year averages.



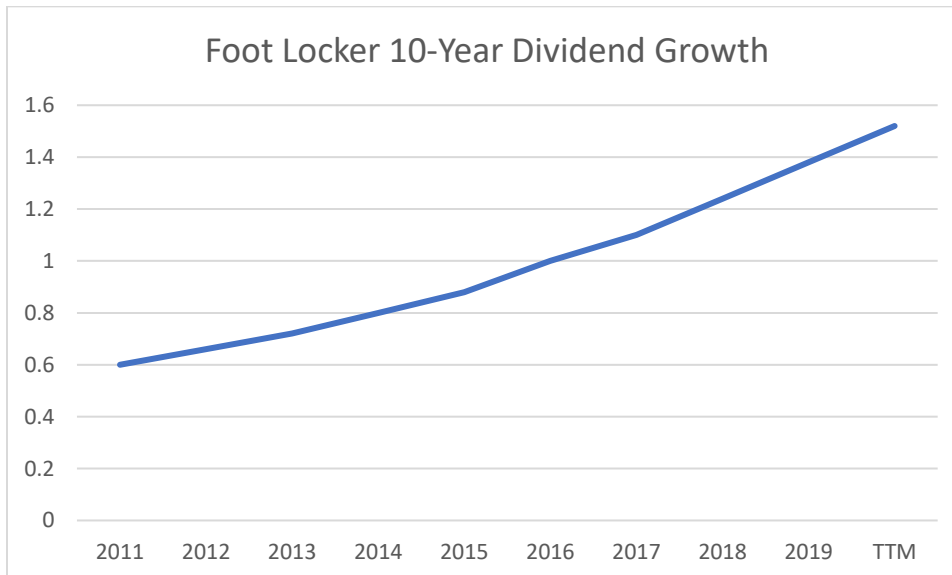
This shows that despite Foot Locker is past the stage where it had growth rates north of 30% in terms of its operating income and revenue, it is still able to achieve growth. When looking at

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Foot Locker's growth strategies, it is likely that the company will be able to sustain its stable performance. Adding on, an outstanding attribute about Foot Locker is that it has very low debt. All the way leading up to the pandemic, Foot Locker's debt/equity ratio was only 0.05 and only when it closed its stores, its debt/equity ratio rose just above 1. For more proof of how strong its balance sheet is, its current ratio is still at a 2.00 during the pandemic while the quick ratio dropped to a 0.84.

Liquidity/Financial Health	2011-01	2012-01	2013-01	2014-01	2015-01	2016-01	2017-01	2018-01	2019-01	2020-01	Latest Qtr
Current Ratio	3.96	3.79	3.72	3.75	3.53	3.72	4.30	4.14	3.30	2.00	2.00
Quick Ratio	1.42	1.64	1.57	1.54	1.50	1.59	1.88	1.55	1.31	0.84	0.84
Financial Leverage	1.43	1.45	1.42	1.40	1.43	1.48	1.42	1.57	1.52	2.66	2.66
Debt/Equity	0.07	0.06	0.06	0.05	0.05	0.05	0.05	0.05	0.05	1.13	1.13

However, this shows that Foot Locker is managing its assets and taking care of its liabilities. Foot Locker's dividends have been consistently increasing for the past 10 years which shows reliability in its dividend payments. This is a clear sign that Foot Locker is an industry leader with enough cash flow to pay its shareholders as well as pay its liabilities.



During this pandemic, Foot Locker's price got cut in half which puts this company in an extremely undervalued position. With a P/E ratio of only 5.04 and a P/B ratio of 0.94, Foot Locker's value is severely mistaken. By the time the economy recovers, Foot Locker's expected price is to be at least \$28.32.

### Investment Thesis

During this period of the pandemic, Foot Locker's discounted price makes this company an extremely attractive investment. A buy recommendation is set for this company due to the current economic events as well as the abundant gain an investor could receive from investing in this company from its consistent dividend yield, future price appreciation and attractive book value. As said before, the fact that Foot Locker can provide its investors with an attractive

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dividend yield of almost 7% during this crisis shows how financially strong this company is. This also reflects the fact that the company's book value is attractive as well especially compared to its price which yields a P/B ratio of 1.02. By comparing Foot Locker's price of \$23.04 today and with its price of \$40.38 before the economic crisis, investors can expect their investments to attain abundant returns.

### **Industry Leader**

Although Foot Locker's market capitalization is not of overwhelming size, it still proves itself to be a leader in what it sells. This is also mainly because the companies that are being compared with Foot Locker concentrate in selling clothes rather than shoes which is what Foot Locker specializes in. Other than Kid's and Lady Foot Locker, the company also owns Champs Sports, Footaction as well as Eastbay, all of whom are well recognized footwear retailers. Additionally, Foot Locker's international presence is also dominant as it has stores across 27 different countries. Furthermore, Foot Locker also supplies a variety of brands that some of its competitors own such as Vans or Timberlands. By having solid relationships with its suppliers such as Nike and Adidas along with the fact that it sells its competitor's brands, Foot Locker not only raises the barriers to entry but also gains a cost advantage which will allow it to charge a premium on its products.

### **Invested in Culture**

Something that Foot Locker does extremely well is how it is able to keep up with the ever-changing fashion trends of the youth. Foot Locker gives credit to its relationship with its suppliers for being able to have this advantage. The supplier-buyer relationship that Foot Locker has with some of the top footwear and clothing manufacturers allow the company to provide its customers with the latest and greatest products on time and with enough quantity. Aside from selling shoes, Foot Locker also sells the latest clothing brands that are contributing to today's fashion scene such as Champion, FILA, and Kappa. With such a wide assortment of products, it guarantees that Foot Locker will be able to not only bring in new customers but retain old ones as well. Moreover, Foot Locker has been partnering with e-commerce start-ups that are popular amongst the youth fashion culture such as GOAT and Pensole. To continue, Foot Locker has also established new stores called "Power Stores" where the atmosphere is more than just a shop, but a place where people can game, listen to music and relax. Foot Locker does not only sell products that consumers want but offers a place where consumers want to be at. By investing in the current social trend and creating brand awareness in its target markets, Foot Locker becomes the 4th most engaged company on Forbes' 50 most engaged customer list.

### **Strong Financials**

Other than quality, the quantitative value of Foot Locker is also very appealing. Foot Locker's average operating margin over the past 5 years is an impressive 13.04% compared to the industry's range of 4% - 13%. The company's efficient and effective way of generating cash



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is also reflected in its balance sheet where its working capital has exceeded \$1.5 billion for the past 5 years and remains above \$1 billion at the beginning of this year. Furthermore, this company is far from bankruptcy as it can use its current assets to pay off all its liabilities both short and long term. Foot Locker's financial health shows its ability to not only be a stable performer normally but also a company that can withstand economic crises such as the one occurring today.

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## Comparable Companies Analysis

Operating Statistics:																
Company Name	Capitalization			LTM	Revenue			LTM	EBITDA			LTM	Net Income			Source: Company Filings
	Equity Value	Enterprise Value			FY20	FY21			FY20	FY21			FY20	FY21		
Under Armour, Inc.	\$ 4,519.0	\$ 4,794.4		5,267.1	\$ 4,420.0	\$ 5,290.0		\$ 428.7	\$ 156.0	\$ 338.0		\$ 92.1	\$ (81.5)	\$ 88.2		
DICK'S Sporting Goods, Inc.	2,401.9	5,437.8		8,750.7	6,700.0	7,960.0		696.6	713.0	425.0		320.0	297.0	131.0		
Skechers U.S.A., Inc.	4,772.0	4,855.6		5,208.2	4,640.0	5,560.0		517.4	349.0	591.0		347.0	116.0	313.0		
V.F. Corporation	21,538.8	24,492.7		14,313.9	11,380.0	10,160.0		2,345.2	1,825.0	1,501.0		1,260.0	1,209.0	860.0		
Nike, Inc.	136,948.9	140,892.4		41,274.0	38,830.0	41,900.0		5,860.0	4,942.0	5,685.0		4,029.0	3,523.0	4,082.0		
Adidas AG	44,982.6	46,063.1		24,435.5	21,120.0	24,550.0		2,630.3	1,916.0	3,504.0		1,976.0	781.0	1,762.0		
Maximum	\$ 136,948.9	\$ 140,892.4		\$ 41,274.0	\$ 38,830.0	\$ 41,900.0		\$ 5,860.0	\$ 4,942.0	\$ 5,685.0		\$ 4,029.0	\$ 3,523.0	\$ 4,082.0		
75th Percentile	8,963.7	40,670.5		21,905.1	18,685.0	20,952.5		2,559.0	1,893.3	3,003.3		1,797.0	1,102.0	1,536.5		
Median	\$ 4,645.5	\$ 14,965.3		\$ 11,532.3	\$ 9,040.0	\$ 9,060.0		\$ 1,520.9	\$ 1,269.0	\$ 1,046.0		\$ 803.5	\$ 539.0	\$ 586.5		
25th Percentile	3,989.7	5,001.2		6,138.0	5,155.0	6,160.0		562.2	440.0	466.5		326.8	161.3	176.5		
Minimum	2,401.9	4,794.4		5,208.2	4,420.0	5,290.0		428.7	156.0	338.0		92.1	(81.5)	88.2		

Foot Locker Inc	\$ 2,400.8	\$ 4,813.8	\$ 7,307.2	\$ 7,035.7	\$ 7,539.1	\$ 913.0	\$ 429.2	\$ 520.2	\$ 541.0	\$ 498.0	\$ 333.0	7.2%	21.2%	12.5%	6.1%	6.9%
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Valuation Statistics:																
Company Name	Capitalization			Enterprise Value /			Enterprise Value /			P / E Multiple			LTM	FY20	FY21	LTM
	Equity Value	Enterprise Value		Revenue	FY20	FY21	EBITDA	FY20	FY21		FY20	FY21				
Under Armour, Inc.	\$ 4,519.0	\$ 4,794.4		0.9 x	1.1 x	0.9 x	11.2 x	30.7 x	14.2 x	49.1 x	NM	51.2 x				
DICK'S Sporting Goods, Inc.	2,401.9	5,437.8		0.6 x	0.8 x	0.7 x	7.8 x	7.6 x	12.8 x	7.5 x	8.1 x	18.3 x				
Skechers U.S.A., Inc.	4,772.0	4,855.6		0.9 x	1.0 x	0.9 x	9.4 x	13.9 x	8.2 x	13.8 x	41.1 x	15.2 x				
V.F. Corporation	21,538.8	24,492.7		1.7 x	2.2 x	2.4 x	10.4 x	13.4 x	16.3 x	17.1 x	17.8 x	25.0 x				
Nike, Inc.	136,948.9	140,892.4		3.4 x	3.6 x	3.4 x	24.0 x	28.5 x	24.8 x	34.0 x	38.9 x	33.5 x				
Adidas AG	44,982.6	46,063.1		1.9 x	2.2 x	1.9 x	17.5 x	24.0 x	13.1 x	22.8 x	57.6 x	25.5 x				
Maximum	\$ 21,538.8	\$ 24,492.7		1.7 x	2.2 x	2.4 x	11.2 x	30.7 x	16.3 x	49.1 x	41.1 x	51.2 x				
75th Percentile	8,963.7	10,201.5		1.1 x	1.4 x	1.3 x	10.6 x	18.1 x	14.7 x	25.1 x	29.5 x	31.6 x				
Median	\$ 4,645.5	\$ 5,146.7		0.9 x	1.1 x	0.9 x	9.9 x	13.7 x	13.5 x	15.4 x	17.8 x	21.7 x				
25th Percentile	3,989.7	4,840.3		0.8 x	1.0 x	0.8 x	9.0 x	12.0 x	11.7 x	12.2 x	13.0 x	17.6 x				
Minimum	2,401.9	4,794.4		0.6 x	0.8 x	0.7 x	7.8 x	7.6 x	8.2 x	7.5 x	8.1 x	15.2 x				
Foot Locker Inc	\$ 2,401	\$ 4,814		0.7 x	0.7 x	0.6 x	5.3 x	11.2 x	9.3 x	4.4 x	4.8 x	7.2 x				

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### **Comparable Companies Analysis Rationale**

The companies that Foot Locker is being compared to are based on the assortment of products that they offer as well as the retail industry that the companies share. Most of the companies that are being compared to Foot Locker also supply the company such as Nike and Adidas. The reason being is that these leading brands provide Foot Locker with its products and enable the company to perform at a level comparable to its suppliers.

Since a vast amount of Foot Locker's products are directed at footwear for athletes, it would make sense for them to be compared with brands that are known for their athletic products such as Under Armour and Dick's Sporting Goods. Skechers is a company that is quite like Foot Locker as they both specialize in footwear retailing; the difference is that Skechers manufactures their own shoes while Foot Locker relies on its suppliers. V.F. Corporation, Nike and Adidas are Foot Locker's suppliers so it would be fair to compare these companies as Foot Locker shares the same products as these companies.

When analyzing the comparable company table, it shows that Foot Locker is undervalued compared to its competitors in almost every aspect. All its valuation multiples are trading much lower than the median as well. Foot Locker's value comes from how it can maintain an extremely strong cash position which is backed by its ability to pay out attractive dividends. Furthermore, Foot Locker's recent investments into new stores and fashion culture may prove to be catalysts for major price appreciation which investors can look forward to.

Despite Foot Locker's attractive multiples, the company's projected revenue and EBITDA growth rates are below average. To address this, Foot Locker is a company that has reached a stage of maturity which would explain a projected revenue growth rate of only 7.2% and an EBITDA growth rate of 21.2% which are both below median rates. Due to the current pandemic, Foot Locker most likely did not reap the full gain of its international expansion and investments. However, as said before, when Foot Locker recovers from the effects of COVID-19, the company has solid potential to continue growing at a stable rate after it returns to fair value as well.

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## Discounted Cash Flow Analysis

Foot Locker Inc - FCF Projections:	Units:	Historical			Projected									
		FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29
Operating Income (EBIT):	\$ M	1,000.0	571.0	699.0	281.4	377.0	479.5	588.4	655.7	717.9	733.4	749.2	765.4	781.9
Net Operating Profit After Taxes (NOPAT):	\$ M	651.7	372.1	455.6	183.4	245.7	312.5	383.5	427.3	467.9	478.0	488.3	498.8	509.6
<b>Adjustments for Non-Cash Charges:</b>														
(+) Depreciation & Amortization:	\$ M	173.0	178.0	179.0	147.7	143.2	143.8	142.9	122.4	116.7	119.2	121.8	124.4	127.1
% Revenue:	%	2.2%	2.2%	2.2%	2.1%	1.9%	1.8%	1.7%	1.4%	1.3%	1.3%	1.3%	1.3%	1.3%
(+/-) Deferred Income Taxes:	\$ M	105.0	9.0	5.0	(9.8)	(10.5)	(10.0)	(8.2)	(4.6)	(3.8)	(3.8)	(3.9)	(4.0)	(4.1)
% Income Statement Taxes:	%	30.9%	4.6%	2.5%	10.0%	8.0%	6.0%	4.0%	2.0%	1.5%	1.5%	1.5%	1.5%	1.5%
Net Change in Working Capital:	\$ M	(91.0)	(25.0)	213.0	96.9	(25.2)	(31.7)	(29.0)	(23.5)	(16.3)	(13.5)	(13.8)	(14.1)	(14.5)
(-) Capital Expenditures:	\$ M	(266.0)	(274.0)	(187.0)	(175.9)	(173.4)	(159.8)	(151.3)	(139.9)	(134.6)	(137.5)	(140.5)	(143.5)	(146.6)
<b>Unlevered Free Cash Flow:</b>	<b>\$ M</b>	<b>\$ 572.7</b>	<b>\$ 260.1</b>	<b>\$ 665.6</b>	<b>\$ 242.4</b>	<b>\$ 179.8</b>	<b>\$ 254.8</b>	<b>\$ 337.9</b>	<b>\$ 381.7</b>	<b>\$ 430.0</b>	<b>\$ 442.3</b>	<b>\$ 451.8</b>	<b>\$ 461.6</b>	<b>\$ 471.5</b>
Growth Rate:	%	N/A	(54.6%)	155.9%	(63.6%)	(25.8%)	41.7%	32.6%	13.0%	12.6%	2.9%	2.2%	2.2%	2.2%
Discount Period:	#				1	2	3	4	5	6	7	8	9	10
Discount Rate (WACC):	%				7.31%	7.31%	7.31%	7.31%	7.31%	7.31%	7.31%	7.31%	7.31%	7.31%
Cumulative Discount Factor:	#				0.932	0.868	0.809	0.754	0.703	0.655	0.610	0.569	0.530	0.494
PV of Unlevered FCF:	\$ M				\$ 225.9	\$ 156.2	\$ 206.2	\$ 254.8	\$ 268.3	\$ 281.6	\$ 269.9	\$ 257.0	\$ 244.6	\$ 232.9
<b>EBITDA:</b>	<b>\$ M</b>	<b>\$ 1,173.0</b>	<b>\$ 749.0</b>	<b>\$ 878.0</b>	<b>\$ 429.2</b>	<b>\$ 520.2</b>	<b>\$ 623.3</b>	<b>\$ 731.3</b>	<b>\$ 778.1</b>	<b>\$ 834.6</b>	<b>\$ 852.6</b>	<b>\$ 871.0</b>	<b>\$ 889.8</b>	<b>\$ 909.0</b>
Growth Rate:	%	N/A	(36.1%)	17.2%	(51.1%)	21.2%	19.8%	17.3%	6.4%	7.3%	2.2%	2.2%	2.2%	2.2%

### Terminal Value - Perpetuity Growth Method:

Discount Rate (WACC): 7.31%

Expected Long-Term GDP Growth: —

Baseline Terminal FCF Growth Rate: (0.5%)

Baseline Terminal Value: \$ 6,007.7

Implied Terminal EBITDA Multiple: 6.6 x

(+) PV of Terminal Value: 2,967.1

(+) Sum of PV of Free Cash Flows: 2,397.3

**Implied Enterprise Value: \$ 5,364.4**

**Implied Equity Value: 2,951.4**

Diluted Shares Outstanding: 104.200

**Implied Share Price from DCF: \$ 28.32**

**Premium / (Discount) to Current: 22.9%**

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## **Discounted Cash Flow Rationale**

The discounted cash flow analysis was constructed to justify the qualitative strengths of Foot Locker. This model is used to estimate what the company's future cash flow will be like in 10 years and after the projections are made, they are discounted back to their present values using the weighted average cost of capital or WACC. The main idea behind this discounted cash flow analysis is to prove that the market has mispriced the company by finding its intrinsic value and use the intrinsic value to further explain why Foot Locker is undervalued and a worthy investment.

The weighted average cost of capital is used as the discount rate for discounting free cash flows because the cash a company generates should at least be able to cover its costs to breakeven. The WACC used was calculated by first taking the median unlevered beta of Foot Locker's comparable companies and then re-levering the beta to find the current and optimal capital structure for Foot Locker. The cost of equity is then calculated based on the current capital structure, the optimal capital structure and based on historical beta. After finding the 3 types of costs of equity, 3 WACC percentages are calculated based on the current, optimal and historical costs of equity. Lastly, the average WACC between the 3 WACC percentages is the one used as the discount rate.

The effects of COVID-19 had a negative impact on every company's performance and drastically affected the economy's growth which explains the -0.5% terminal growth rate. By examining the discounted cash flow model, it is evident that Foot Locker's price will eventually return to its normal state. From the analysis, Foot Locker's implied share price is \$28.32 which implies a possible 22.9% upside. Since Foot Locker is a mature company, exponential growth after the price has returned to normal is uncertain. However, due to the company's strong financials, Foot Locker will be a stable performer in a market who can supply the investors with satisfactory dividends. Overall, Foot Locker's discounted price presents a valuable investment opportunity that has the potential to yield substantial returns.

## **Risks**

### **Vertical Mergers**

Although Foot Locker is a leader in footwear retail, Foot Locker still faces threats from its competitors. This is because footwear manufacturers such as Nike and Adidas are starting to vertical integrate into becoming distributors as well. These companies pose an immense threat due to their supply chain as well as market size. In terms of brand awareness, Nike and Adidas are the reigning leaders of footwear, sports apparel, equipment, and accessories. By having their own retail stores gives them the opportunity to steal some of Foot Locker's customers. Furthermore, if Nike and Adidas choose to only supply their own distribution, this would pose a threat to Foot Locker because it would limit the range of customers that the company can reach and retain. Despite these risks, Foot Locker's strong supplier relationships with Nike and Adidas

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will most likely prevent the risk from growing. Additionally, Foot Locker's other advantages lies in the variety of brands that it can offer in one location, and the ability to turn its stores into a hang-out spot rather than just a place to buy products.

### **Changing Consumer Preferences**

Another risk that Foot Locker faces is the everchanging preferences of its customers. Despite Foot Locker being able to sell a variety of products, it cannot guarantee nor predict that customers will like their products in the future. Considering the fact that Foot Locker sells to a younger demographic that focuses on athletic and street fashion trends, if the company's target demographic shifts its preference away from these trends, Foot Locker's business will be at risk. Furthermore, the time it takes for Foot Locker to order and stock new inventory is not a fast process either so a sudden change in consumer preferences can damage the business substantially. Foot Locker can mitigate this risk by staying updated with the latest fashion trends. They can do this by being invested in current fashion culture and sporting events. In order for Foot Locker to keep customers from switching stores, they can use their mobile apps and loyalty programs to offer exclusive deals and sneaker releases.

### **Catalysts**

#### **Power Stores**

Through a partnership with Nike, these power stores concentrate on providing excellent customer experience as spread insight on current fashion trends. On this journey to empower youth culture, these stores are aiming to become the core of entertainment by providing art, music, and sports for customers to enjoy. These stores that are approximately 4 times larger than the regular Foot Locker store will be able to connect with consumers on a brand new scale due to Nike's implementation of technology that will allow members of its loyalty program to scan their barcodes and receive a chance to purchase limited-edition items in-store. These new stores give the company new potential as it seeks to become more connected with its customers, driving sales up and increasing customer retention.

### **Conclusion**

Overall, investors can expect to see substantial return from Foot Locker once this pandemic is over, which will result in the company's price returning to of value. With a wide and deep economic moat, and a prominent international and national presence, the company is well positioned in the footwear retail industry. The company's strong relationship with its suppliers and an abundant amount of cash paired with the fact that it has very low debt grants the company safety. Due to the strengths that this company possesses and the current economic condition, Foot Locker is a worthwhile investment that can be bought at an undervalued price of \$23.04 with a target price of \$28.32.

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Appendices

Revenue and Operating Margin Projections

Revenue and Expense Projections:		Historical			Projected									
		Units:	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28
Net Sales by Segment:														
United States	\$ M	\$ 5,532.0	\$ 5,647.0	\$ 5,691.0	\$ 4,837.4	\$ 5,176.0	\$ 5,486.5	\$ 5,788.3	\$ 6,019.8	\$ 6,170.3	\$ 6,293.7	\$ 6,419.6	\$ 6,548.0	\$ 6,678.9
International	\$ M	2,250.0	2,292.0	2,314.0	2,198.3	2,363.2	2,505.0	2,617.7	2,722.4	2,804.1	2,874.2	2,946.0	3,019.7	3,095.2
Total Consolidated Sales:	\$ M	\$ 7,782.0	\$ 7,939.0	\$ 8,005.0	\$ 7,035.7	\$ 7,539.1	\$ 7,991.5	\$ 8,406.0	\$ 8,742.2	\$ 8,974.4	\$ 9,167.9	\$ 9,365.6	\$ 9,567.7	\$ 9,774.1
Annual Growth Rate:	%	0.2%	2.0%	0.8%	(12.1%)	7.2%	6.0%	5.2%	4.0%	2.7%	2.2%	2.2%	2.2%	2.2%
Growth Rates by Segment:														
United States	%	(0.5%)	2.1%	0.8%	(15.0%)	7.0%	6.0%	5.5%	4.0%	2.5%	2.0%	2.0%	2.0%	2.0%
International	%	2.1%	1.9%	1.0%	(5.0%)	7.5%	6.0%	4.5%	4.0%	3.0%	2.5%	2.5%	2.5%	2.5%
Operating Income by Segment:														
Total	\$ M	1,000.0	571.0	699.0	281.4	377.0	479.5	588.4	655.7	717.9	733.4	749.2	765.4	781.9
Operating Margin by Segment:														
Total	%	12.9%	7.2%	8.7%	4.0%	5.0%	6.0%	7.0%	7.5%	8.0%	8.0%	8.0%	8.0%	8.0%

Financials and Operating Model

Foot Locker Inc - FCF Projections:		Units:	Historical			Projected										Source: Company Filings	
			FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29		
Revenue:	\$ M	\$ 7,782.0	\$ 7,939.0	\$ 8,005.0	\$ 7,035.7	\$ 7,539.1	\$ 7,991.5	\$ 8,406.0	\$ 8,742.2	\$ 8,974.4	\$ 9,167.9	\$ 9,365.6	\$ 9,567.7	\$ 9,774.1			
Revenue Growth Rate:	%	0.2%	2.0%	0.8%	(12.1%)	7.2%	6.0%	5.2%	4.0%	2.7%	2.2%	2.2%	2.2%	2.2%			
Operating Income (EBIT):	\$ M	1,000.0	571.0	699.0	281.4	377.0	479.5	588.4	655.7	717.9	733.4	749.2	765.4	781.9			
Operating Margin:	%	12.9%	7.2%	8.7%	4.0%	5.0%	6.0%	7.0%	7.5%	8.0%	8.0%	8.0%	8.0%	8.0%			
Growth Rate:	%	155.6%	(42.9%)	22.4%	(59.7%)	33.9%	27.2%	22.7%	11.4%	9.5%	2.2%	2.2%	2.2%	2.2%			
(-) Taxes, Excluding Effect of Interest:	\$ M	(348.3)	(198.9)	(243.4)	(98.0)	(131.3)	(167.0)	(204.9)	(228.4)	(250.0)	(255.4)	(260.9)	(266.6)	(272.3)			
Net Operating Profit After Taxes (NOPAT):	\$ M	651.7	372.1	455.6	183.4	245.7	312.5	383.5	427.3	467.9	478.0	488.3	498.8	509.6			
Adjustments for Non-Cash Charges:																	
(+) Depreciation & Amortization:	\$ M	173.0	178.0	179.0	147.7	143.2	143.8	142.9	122.4	116.7	119.2	121.8	124.4	127.1			
% Revenue:	%	2.2%	2.2%	2.2%	2.1%	1.9%	1.8%	1.7%	1.4%	1.3%	1.3%	1.3%	1.3%	1.3%			
(+/-) Deferred Income Taxes:	\$ M	105.0	9.0	5.0	(9.8)	(10.5)	(10.0)	(8.2)	(4.6)	(3.8)	(3.8)	(3.9)	(4.0)	(4.1)			
% Income Statement Taxes:	%	30.9%	4.6%	2.5%	10.0%	8.0%	6.0%	4.0%	2.0%	1.5%	1.5%	1.5%	1.5%	1.5%			
Net Change in Working Capital:	\$ M	(91.0)	(25.0)	213.0	96.9	(25.2)	(31.7)	(29.0)	(23.5)	(16.3)	(13.5)	(13.8)	(14.1)	(14.5)			
% Change in Revenue:	%	(568.8%)	(15.9%)	322.7%	(10.0%)	(5.0%)	(7.0%)	(7.0%)	(7.0%)	(7.0%)	(7.0%)	(7.0%)	(7.0%)	(7.0%)			
% Revenue:	%	(1.2%)	(0.3%)	2.7%	1.4%	(0.3%)	(0.4%)	(0.3%)	(0.3%)	(0.2%)	(0.1%)	(0.1%)	(0.1%)	(0.1%)			
(-) Capital Expenditures:	\$ M	(266.0)	(274.0)	(187.0)	(175.9)	(173.4)	(159.8)	(151.3)	(139.9)	(134.6)	(137.5)	(140.5)	(143.5)	(146.6)			
% Revenue:	%	3.4%	3.5%	2.3%	(2.5%)	(2.3%)	(2.0%)	(1.8%)	(1.6%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)			

Precedent Transactions

Foot Locker Inc - Comparable M&A Transactions:						Valuation Multiples			
Acquirer Name		Target Name	Announcement Date	Transaction Enterprise Value	LTM Revenue	LTM EBITDA	EV / LTM Revenue	EV / LTM EBITDA	
VF Corporaton		Williamson-Dickie Mfg. Co.	2017-10-02	\$ 820.0	\$ 875.0	N/A	0.9 x	N/A	
Farfetch		Stadium Goods	2019-01-04	250.0	100.0		2.5 x		0.8 x
Michael Kors		Jimmy Choo	2017-07-25	1,200.0	260.0	68.5	4.6 x		17.5 x
				Maximum	\$ 1,200.0	\$ 875.0	\$ 301.0	4.6 x	17.5 x
				75th Percentile	1,010.0	567.5	242.9	3.6 x	13.3 x
				Median	\$ 820.0	\$ 260.0	\$ 184.8	2.5 x	9.2 x
				25th Percentile	535.0	180.0	126.6	1.7 x	5.0 x
				Minimum	250.0	100.0	68.5	0.9 x	0.8 x