④GRANT'S
INTEREST RATE OBSERVER®
Vol. 31, No. 3be Two Wall Street, New York, New York 10005 • www.grantspub.com FEBRUARY 8, 2013

Standing pat

In which we update, and reiterate, our views on a pair of familiar Grant's names

Kohl's on sale?

Add to the many merits of Kohl's Corp. (*Grant's*, Jan. 25) a new Bloomberg-circulated speculation: The Menomonee Falls (Wis.) retailer is ripe for an LBO—so, at least, venture Edward Jones & Co. and Morningstar, according to a Jan. 31 Bloomberg bulletin.

Quoth Bloomberg: "With exclusive brands from Jennifer Lopez and Vera Wang that help build customer loyalty and a free cash flow yield that's higher than the median of its peers, Kohl's could be an attractive buyout candidate for a private equity firm. . . . The company's real estate also adds to its appeal. . . . A takeover of Kohl's, which has an enterprise value of $14.5 billion, would be the biggest U.S. retail deal since 2005, data compiled by Bloomberg show."

Although Kohl's declined to dignify the Bloomberg story with a comment, a corporate spokesperson did respond to a query from *Grant's*. "No comment," she said.

Guesswork is one thing, but there's no need to speculate whether a private-equity buyer could finance a bid. As noted elsewhere in these pages, the markets for junk bonds and leveraged loans have rarely been more accommodating. Bloomberg quotes an estimate that "committed unspent capital dedicated to buyout funds in the global market" totals $360 billion. Ben Bernanke would want them to spend it.

•

Fried chicken

On Tuesday's earnings call, Yum! Brands likened the hubbub in China over food impurities—a public outcry that has contributed to a drop of 17% in the Yum share price since November—to the avian flu crisis of 2005. In the 2005 affair, related CEO David Novak, KFC restaurant sales plunged 40%, but growth resumed in a month. Callers-in were invited to imagine that today's difficulties will be similarly surmounted, although, as management acknowledged, seven weeks after the chicken-doping scandal exploded on Dec. 18, there's still no recovery at the cash register. In January and February, in fact, the company is projecting a 25% drop in same-store China receipts.

Grant's remains bearish on Yum, which, at 20 or so times the forward earnings estimate, is no commanding bargain yet. And we remain bearish, too, on the People's Republic, from which Yum last year plucked 50% of its revenues and 44% of its operating income (see the analyses dated Oct. 5 and Oct. 19).

"While the scandal, in which Yum's China suppliers are accused of flouting regulations on antibiotic levels, among other misdeeds, has undoubtedly exacerbated Yum's China problem, traffic at stores open at least one year had declined by 1% in the third quarter, well before the antibiotic story appeared," observes colleague Charley Grant. "In December, Yum had warned that same-store sales would fall by 4% in China in the extra-long fourth quarter (which starts in September), also before the news broke. While management had no problem admitting that the economic environment in the United States is lackluster, a question on the Chinese macro situation from John Glass at Morgan Stanley did not yield a direct answer beyond the admission of 'some weakness in a broader retail environment.' On Tuesday, the Chinese-language newspaper *Want Daily* reported that nearly 40% of Chinese enterprises cut the size of bonuses paid to employees ahead of the Chinese new year on Feb. 10.

"There's no gainsaying the long-term success of Yum Brands in China, or, for that matter, its early success in Russia and India," Grant winds up. "But as for the closing of the food scandal and the start of recovery in Yum's main market, the timing is very much in question."

•