

Kroger

(NYSE:KR)

May 18th 2023



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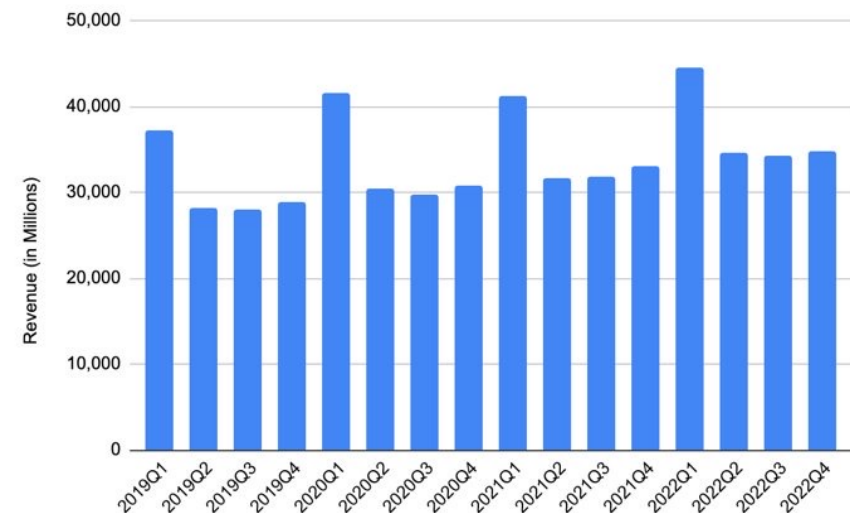
Our Recommendation

Overview



- Kroger is a consumer staple retail grocer, a leader in the industry
- Owns a wide umbrella of subsidiaries, including QFC, Fred Meyer, and Ralph's
 - These offer their own customer and geographic niches
- Aims to sell food that is both affordable and tailored to consumer demands, such as plant-based options.
- Operates nearly 2,800 stores across 35 states.
- Recently, Kroger has had an increased focus on technological innovation to improve convenience.

Ticker	NYSE: \$KR
Current Price	\$49.25
52 Week Low – High	\$41.82 - \$54.04
Market Cap	\$35.206B
P/E Ratio	16.04



YTD Stock Performance



Kroger Company (The) · 1D · NYSE

49.33 0.00 49.33

Vol 4.532M

ACI, CBOE ONE -24.50%

^



Brands / Banners



- Each has its own unique positions and target audience
 - Allows Kroger to cater to a more diverse set of customers and maximize market coverage
- Different banners often provide higher profit margins compared to main brand as Kroger has stronger control over pricing
- These also support Kroger's digital initiatives including online grocery and delivery services and its loyalty programs
 - Generate additional revenue streams and drive alternative profits



Summary of Operations

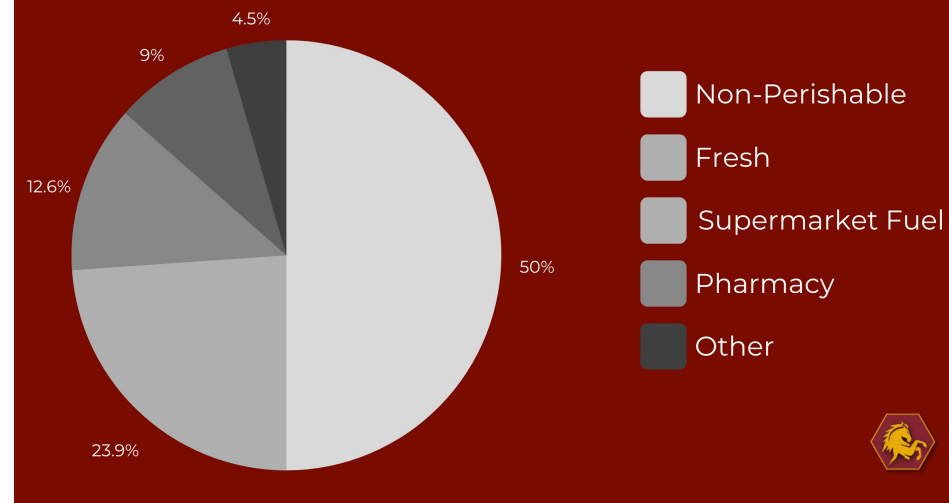


Kroger generates revenue through a diverse array of product offerings

- Specializes food, general merchandise, health and beauty items, apparel, furnishings, electronics, and automotive products
 - 2,726 supermarkets and hypermarkets
 - 2,252 pharmacies
 - 1,613 fuel stations
 - 256 jewelry stores
 - 33 food manufacturing facilities
- Aims to draw customers within a 2 - 2.5 mile radius
- Kroger's Zero Hunger Zero Waste initiative - promotes their ESG initiative and invites customers to join them in their social and environmental impact plan



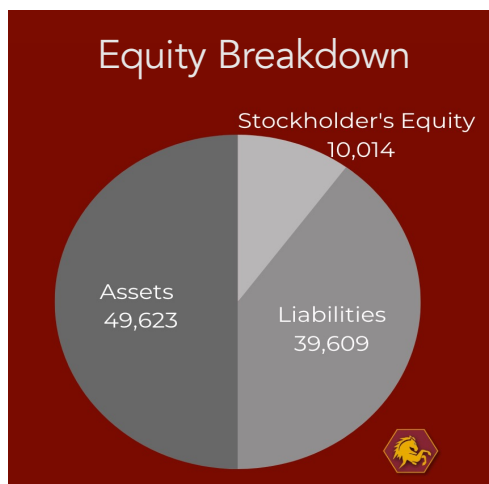
Revenue Breakdown



Financial Analysis



- Projected growth of 12.2% this year (industry average is 8.9%)
- Expected sales growth of 7.5% this year
- Beat projected EPS by 9.48% in January and the two prior projections
- Digital grocery is a \$243B Market – 11% of Kroger's total



Ranking	Name
1	Walmart
2	Amazon
3	Kroger
4	Target
5	Albertsons

Ticker	NYSE: \$KR
Market Cap	\$35.27B
Enterprise Value	\$53.53B
Rev Growth YoY	7.52%
EBITDA	\$7.4B
Revenue	\$148.25B

Other Key Metrics

Net Income	\$2.24B
Current Ratio	0.73
Quick Ratio	0.16
Working Capital	-4.56B

Kroger-Albertsons Merger

- Deal worth \$24.6B
- Seamless ecosystem of in-store/online shopping
- Creating broader selection of Brand Products

Management Analysis



CEO - William Rodney McMullen

- Elected Chairman of the Board in 2014
- Became CEO in 2015
- Joined the company in 1978 and has been there ever since

CFO - Gary Millerchip

- SVP and CFO since 2019
- Joined company in 2008 as CEO of Kroger Personal Finance

CIO - Yael Cosset

- Elected SVP and CIO in 2019
- Responsible for Kroger's subsidiary, 84.51 LLC, and Kroger Personal Finance

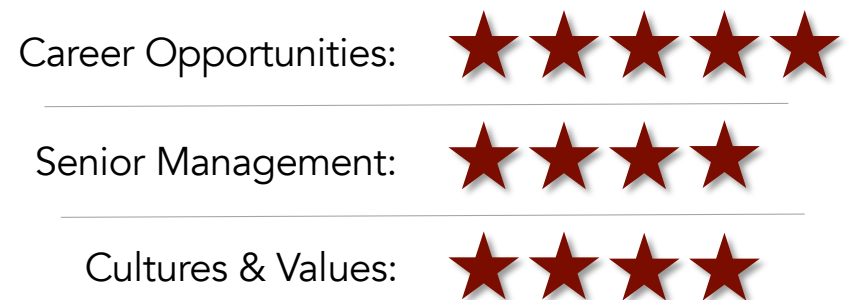
Insider Ownership

William Rodney McMullen: 3.5 million shares

Timothy Massa: 194,956 shares

Gary Millerchip: 185,423 shares

Ratings:



(Ratings provided on Glassdoor)

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Industry Analysis



- Inflation affects consumer spending behavior
 - Fewer overall spending on groceries (buyer)
 - Often leads to an increase in the cost (supplier)
- M&A acceleration in the grocery industry,
 - Merger of Chopper and Tops
 - Raley's acquisition of Bashas
- Online grocery sentiment expansion
 - 68% of all US shoppers said they consider themselves online grocery shoppers (pickup or delivery)
- Private label penetration will continue to rise
 - Survey from FMI found 91% of food retailers and manufacturers planned significantly ramp up their private label the next two years

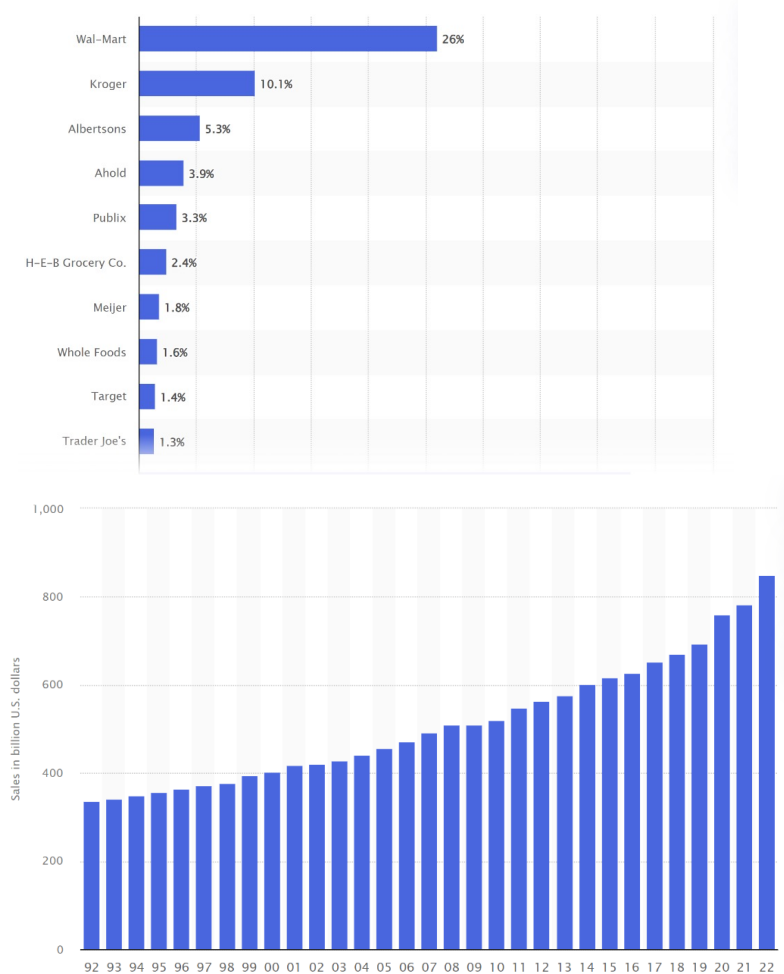


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Partnerships



Technological Innovation

- Partnerships with tech organizations like Extreme Networks, Ocado, 84.51 Data Science, Google, and Microsoft
- Powered by cutting-edge science, 84.51° (KR data intelligence subsidiary) leverages first-party retail data from nearly 50% of US households and more than two billion transactions to fuel a more customer-centric journey



E-commerce

- Driven by partnerships with Ocada, USPS, Instacart, and more.
- Digital sales grew 12%
- Delivery solutions grew 22%
- Digitally engaged households grew by approximately 900,000
- Alternative businesses, including retail media arm Kroger Precision Marketing, generated \$1.2 billion in operating profit in 2022
- Plans to expand in digital destinations, reaching new customers/shopping occasions, in-class fulfillment, and driving their profits

"Kroger's precision-level data and media capabilities have helped Kraft Heinz expand our consumer base by serving up the right messages at the right time, uncovering consumer-led insights that inform platform solutions, and drive trial plus repeat purchases across our portfolio."

-Elizabeth Bennett, VP Global eCommerce, Kraft Heinz



Extensive Ecosystem



Private Label

- \$30 billion (20% of sales and growing)
- Store Brand Sales are up 40% over the past 5 years
- 40% of customers choose lower-cost options
- Pricing power is low as products are the same and switching costs are low

Seamless Ecosystem

Enables Customers to Shop Without Compromise or Complexity



Kroger Precision Marketing

- Over 90% of customer transactions are tied to a Kroger loyalty card
- #1 retail media network for advertising audience and measurement capabilities
- Engages customers and brand partners within their ecosystem

#4th Most Trustworthy Retail Company

Food Brands



Specialty Brands



Why Kroger Over Competitors

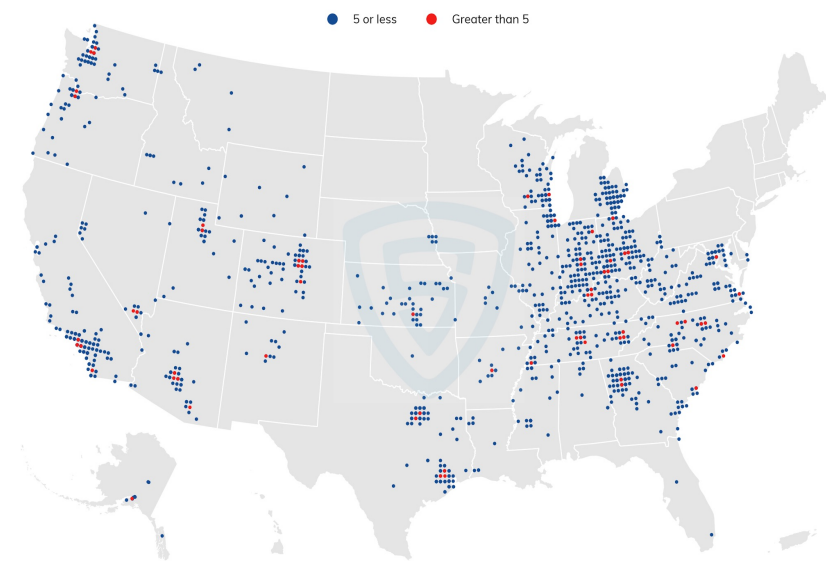


Vertically Integration

- Cost pressures lowered earnings outlook
 - Lower profits were due to soaring labor and transportation cost
- Walmart now sees operating income decline 1% this fiscal year rather than rising 3% as originally forecasted
- Kroger is vertically integrated, meaning it owns much of its supply chain, so it can be more flexible around cost spikes for core products
- Profit margin rose last quarter, and investors are hoping to see similarly strong results

Geographical Advantage

- Located in the Midwest Region
- US initiatives for onshore manufacturing
- Manufacturing jobs create low-paid opportunities and drive population growth in these areas
- Kroger's product portfolio capitalizes on this opportunity



Kroger Company store locations in the USA

Each grid point covers 10-mile radius with at least one location

Source: ScrapeHero.com



Risks and Mitigations



Albertsons Merger Falls Through

Risk

- Antitrust Concerns
 - Damage to consumers and employees caused by concentration in product markets that gives large firms pricing power
 - Kroger and Albertsons could be forced to divest hundreds of stores
 - As the number of stores needed to divest increases, the companies can opt to reassess the transaction

Mitigation

- Strong fundamentals with diversified store offerings and revenue streams despite whether or not merger goes through
- Both CEOs determined that merger *will* lower food prices and no stores will close
- Investors from the very beginning knew of the regulatory risk around the transaction - priced in

Rise of Non- Traditional Grocery Options

- Digital retailing is advancing
- Stores such as Target and Amazon increasing grocery presence
- Changing consumer demand
 - Delivery / mobile

- Developed customer-facing apps and interfaces
- Opening large standalone warehouses that can fulfill thousands of orders a day and cover customers' orders in multiple markets
- Digital sales surged by 12% year over year in the fourth quarter
 - Customers able to shift seamlessly between stores, pickup, and delivery channels

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Financial analysis



- Revenue increased steadily
 - Big jump in 2020 due to its online strength in covid environment
 - Growth has remained steady
- COGS
 - COGS increased in early online years as Kroger built its online platforms
- FCF
 - Most of its profits went to its FCF, the recent decrease likely due to focus on Albertsons acquisitions

Financials	FY18	FY19	FY20	FY21	FY22	FY23
Revenue	\$ 123,280	\$ 121,852	\$ 122,286	\$ 132,498	\$ 137,888	\$ 148,258
y/y Growth	—	1.2%	0.4%	8.4%	4.1%	7.5%
COGS	\$ 95,811	\$ 95,103	\$ 95,294	\$ 101,597	\$ 107,539	\$ 116,480
EBITDA	\$ 6,037	\$ 5,377	\$ 6,338	\$ 7,701	\$ 7,904	\$ 8,296
y/y Growth	—	-11%	18%	22%	3%	5%
Operating Expense	\$ 23,868	\$ 23,837	\$ 24,187	\$ 26,821	\$ 26,114	\$ 27,286
EBIT	\$ 3,601	\$ 2,912	\$ 2,805	\$ 4,080	\$ 4,235	\$ 4,492
Net income						
EPS	2.13	3.84	2.05	3.34	2.22	3.13
y/y Growth	—	80%	-47%	63%	-34%	41%
EPS (diluted)	2.09	3.76	2.04	2.1	2.17	3.06
FCF	—	—	\$ 1,536	\$ 3,950	\$ 3,576	\$ 1,420
y/y Growth	—	—	—	157.16%	-9.47%	-60.29%
Gross Margin	22.28	21.95	22.07	23.32	22.01	21.43
EBITDA Margin	4.9	4.41	5.18	5.81	5.73	5.6
Net Profit Margin	1.28	1.36	1.44	2.07	2.09	2.08
*EV	—	—	\$ 41,915	\$ 45,692	\$ 50,155	\$ 51,624
*ROE	27.98	41.98	20.12	28.44	17.4	23.02
*Debt/Equity	225.76	194.37	247.03	215.57	216.78	203.83
P/E	16.94	14.1	12.43	15.33	11.42	10.68
EV/EBITDA	8.07	7.31	7.25	7.14	7.02	6.51

Comparable Analysis



- Difficult to compare due to the different sized between companies
 - Target has an EV of nearly 10x of Kroger
 - Costco is 5x
- Note the similarities between Kroger and Albertsons
 - about half the size of Kroger but its multiples are nearly identical
 - Also have similar business focus and strategy

	Kroger	Albertsons	Walmart	Costco
Ticker	KR	ACI	WMT	COST
Price	\$ 49.25	\$ 20.19	\$ 149.53	\$ 495.00
Market Cap (\$M)	\$ 35,340	\$ 11,650	\$ 387,441	\$ 219,520
EV (\$M)	\$ 51,624	\$ 28,031	\$ 445,037	\$ 233,450
Revenue (\$M)	\$ 148,258	\$ 77,649	\$ 611,289	\$ 226,954
EBITDA (\$M)	\$ 8,296	\$ 5,062	\$ 37,853	\$ 10,185
EBIT (\$M)	\$ 4,126	\$ 2,275	\$ 20,428	\$ 7,793
EPS	3.13	2.77	6.45	13.49
EV/Sales	0.35	0.36	0.73	1.03
EV/EBITDA	6.22	5.54	11.76	22.92
EV/EBIT	12.51	12.32	21.79	29.96
P/E	15.73	7.29	23.18	36.69
	Sales	EBITDA	EBIT	P/E
Average	0.71	13.41	21.35	22.39
Median	0.73	11.76	21.79	23.18
Averages	0.72	12.58	21.57	22.79

Multiple Analysis & Equity Valuation



Equity Value

Current Trading Multiples

EV / Revenue	0.35
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EV / EBITDA	6.22
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EV / EBIT	12.51
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P/E	15.73
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Industry P/E Multiple	22.79
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Implied Price	\$ 71.32
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Market Price	\$ 49.25
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Upside	44.81%
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Buy

Price Target

~\$55

Implied Upside

11.6%

Time Horizon

3+ Years