

KOHL'S



Kohl's Corporation (NYSE: KSS)

Analyst: Jerlin Kaithamattam

We recommend a marketweight position on KSS' 4.25% Sr. Unsecured notes of 2025. Kohl's Corporation operates as an omnichannel retail company in the United States. Its roughly 1,160 namesake department stores and website offer apparel, footwear, accessories, beauty, and home products. As Covid-19 decimates sales across an already struggling industry, retail companies have been under extreme pressure to maintain profitability and survive in increasingly competitive environments. KSS has implemented initiatives to spur growth in its topline. Most notably, its traffic-driving returns partnership with AMZN has shown promising results in its pilot which we believe will carry over through its nationwide implementation. While we are confident in this partnership, as well as KSS' unique store formats and locations, we are wary of its inability to stimulate growth in its women's segment and offset flat & declining comparable sales. Although the market has not realized the full potential of the AMZN partnership, its positive effects are not great enough to cause KSS' 25s to tighten significantly moving forward, thus we maintain the market's current valuation of these notes.

Bond Data

Bond Maturity: 07/17/2025

Rank: Sr. Unsecured

Rating: BBB-

Price: \$98.07

YTW: 4.700%

Coupon: 4.25%

Z-Spread: 419.9bps

Figure 1: Capitalization Table

KSS Capitalization Table						
LTM EBITDA		1,061.0				
Outstanding Debt Metrics & Leverage						
Type of debt	Rate (%)	Maturity	Debt Outstanding (\$MM)	xLTM Adj. EBITDA	Price	Yield
First Lien Secured Loans						
KSS REV 1L USD			1,000.0		N/A	N/A
Total First Lien Notes			1,000.0	0.94x		
Sr. Unsecured Notes 23	3.250%	2/1/23	350.0		101.45	3.43%
Sr. Unsecured Notes 23	4.750%	12/15/23	184.4		105.46	3.34%
Sr. Unsecured Notes 25	9.500%	5/15/25	600.0		120.28	4.65%
Sr. Unsecured Notes 25	4.250%	7/17/25	649.9		98.07	4.70%
Sr. Unsecured Notes 29	7.250%	6/1/29	42.3		111.08	5.77%
Sr. Unsecured Notes 33	6.000%	1/15/33	112.4		105.74	5.62%
Sr. Unsecured Notes 37	6.875%	12/15/37	100.9		106.76	6.37%
Sr. Unsecured Notes 45	5.550%	7/17/45	426.8		94.13	6.06%
Total Senior Unsecured			3,466.6	3.27x		
Total Debt			3,466.6	3.27x		
Market Capitalization			3,130.3			
Less: Cash			2,428.0			
Enterprise Value			4,168.8	3.93x		

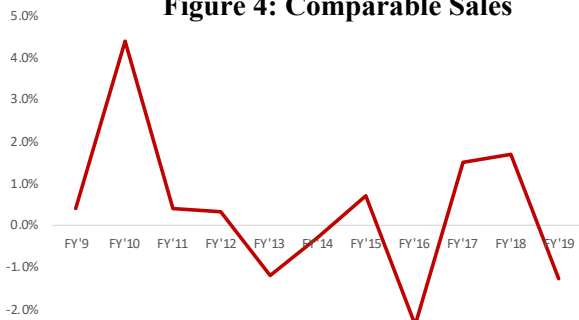
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Traffic Driving Returns Partnership with Amazon

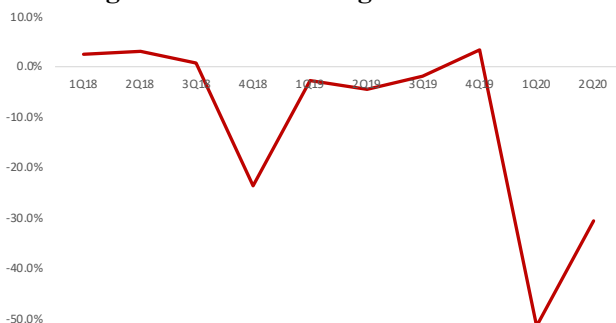
In 2017, KSS made the surprising move to partner up with e-commerce giant, Amazon (AMZN). This partnership allows KSS to accept AMZN returns in Kohl's. The overarching goal of this initiative is to convert traffic that comes to stores into loyal KSS customers over time. The nationwide rollout of this program began in 2019 after a pilot of 82 stores showed extremely positive results. This is illustrated in sales growth from Chicago (pilot location) compared with the rest of the U.S. Chicago sales growth tracks closely to the rest of the U.S. until the first quarter of 2018 (when AMZN partnership launched), where revenue growth tops more than 10%, versus 5% for the rest of the U.S. Data shows that Chicago sales, transactions, and customer growth all outpace the same metrics nationwide for 2018. Most notable is the fact that Kohl's percentage of new customers (customers that did not shop at Kohl's in the prior calendar year) is up 9% versus 1% for the rest of the U.S. - this indicates that the Amazon initiative has driven new customers to store locations. KSS rolled out the nationwide AMZN returns program in 2H 2019. Due to a softer than expected Q3 and Q4 2019 holiday period as a result of continued poor performance in the women's category (~30% of net sales), the impact of AMZN partnership has not been fully realized. While the market's skepticism regarding this partnership was misplaced, we recognize that the women's segment has not shown much promise in recent quarters, and a long-awaited turnaround strategy has yet to be fully underway, leaving investors questioning when the turnaround will materialize.

Figure 4: Comparable Sales



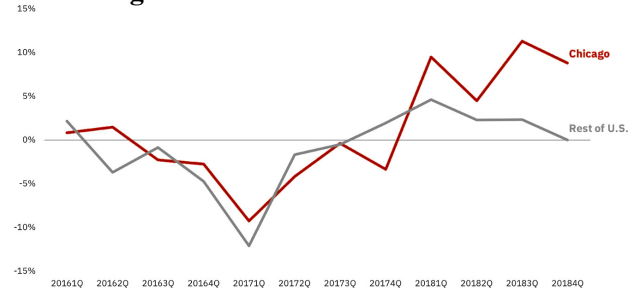
*Source: Company Filings

Figure 5: Women's Segment Growth



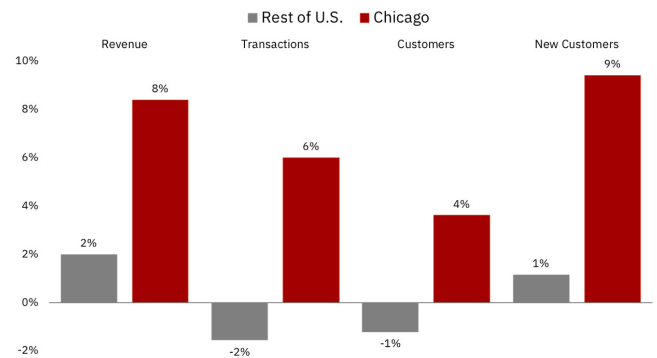
*Source: Company Filings

Figure 2: KSS Revenue Growth Y/Y



*Source: Bloomberg, MFIF Analysis

Figure 3: KSS Key Performance Metrics Growth



*Source: Bloomberg, MFIF Analysis

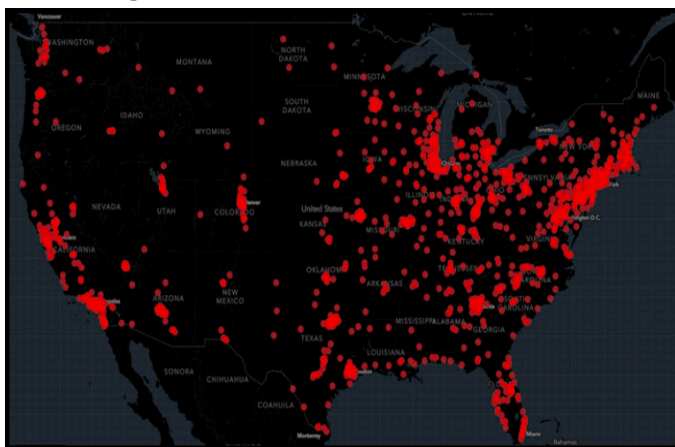
Long-Term Outlook Hinges on Turnaround in Women's Segment and Increase in Comparable Sales

KSS' women's category accounts for ~30% of its total net sales. Prior to Covid, KSS struggled with innovation in Women's. Sales growth has been largely negative since 3Q18. Women's apparel sales have been weak in recent years across the industry as consumers shift to online shopping and competitively priced fast-fashion brands. The pandemic only exacerbated this decline, placing renewed pressure on KSS to correct this and remove underperforming brands. KSS attempted to fix margin pressure through the launch of new brands (Nine West, Scott Living). Though these initiatives spurred customer interest, they have not offset weakness in women's, as evidenced by declining segment growth. In response to this, KSS has developed another turnaround strategy, created by a newly appointed leadership team. This strategy involves exiting 8 underperforming brands and entering new partnerships with Land's End, and TOMS. We are cautiously optimistic about this turnaround strategy, as it has great potential, however it is possible that with the persistence of Covid & rapidly changing consumer interest, its benefits may not increase comparable sales. As a result of the poorly performing women's segment, as well as weaknesses in other segments like home and footwear, comparable sales have been largely declining or flat. Should the turnaround strategy in KSS' women's segment result in substantial growth in 2H2020, comp sales may show positive growth and make its way back to highs of 2018.

Unique Store Formats and Locations will Serve as a Strategic Asset for Navigating Covid Crisis, and Capturing Market Share

According to a 2017 report by Credit Suisse, 20-25% of malls are likely to close in the next 5 years due to thousands of store closings that have been announced. The pandemic has only exacerbated store closures - leaving a great deal of revenue and market share to be claimed. The J. C. Penney bankruptcy (among others) means that there could be a market share of approximately 10-15 billion USD or more per year, which would be split between KSS, JWN, AMZN, and other major players in the retail industry. With a store within 10 miles of half of the JC Penney locations slated to close, and stores within 15 miles of 80% of Americans, KSS is in a solid position to attract new customers. KSS' ability to stay afloat and avoid closure during this crisis is partially attributable to its unique real estate strategy. KSS stands out from other department stores, as 95% of its 1,158 stores are located off mall. KSS' comps, like M and JWN are very heavily centered in mall locations. In fact, of the roughly 1,000 malls open in the US, 6.2% of total square footage is occupied by M, and roughly 1.5% is occupied by JWN. M and other retail stores have begun to realize the negative effects of keeping large stores in malls and have followed in the steps of KSS to begin opening smaller "off-mall" stores in the next two years. The positive effects of this, however, will take quite a bit of time to materialize, whereas this strategy has been one that KSS has been taking advantage of since its inception. We believe that as the pandemic continues, KSS' unique store format will become even more vital, as shoppers may be unable or unwilling to return to crowded-indoor spaces for some time. Thus, we remain confident in KSS' ability to use its unique advantage to survive through the crisis.

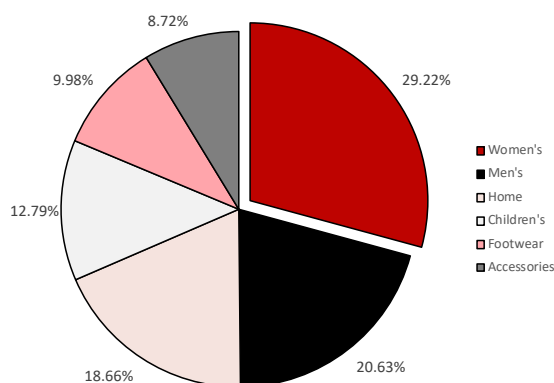
Figure 8: KSS Locations Nationwide



*Source: Bloomberg

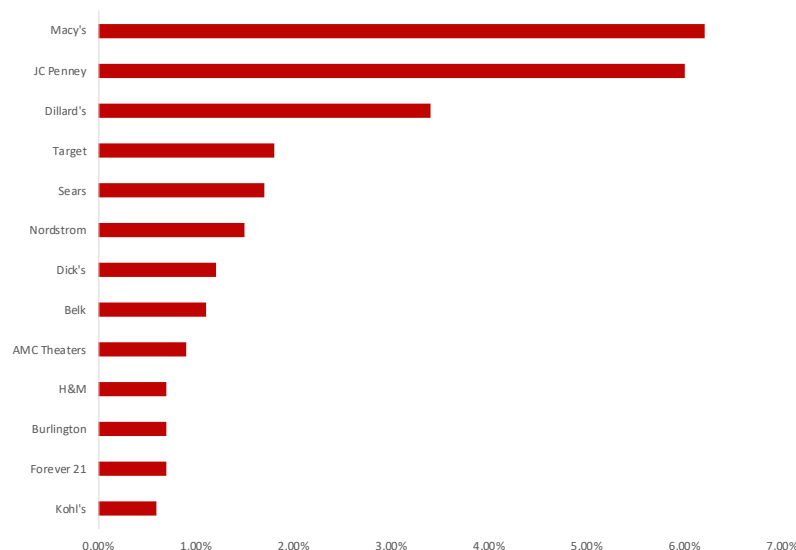
MINUTEMEN FIXED INCOME FUND

Figure 6: Net Sales by Line of Business



*Source: Company Filings

Figure 7: Occupants of US Mall Space



*Source: Bloomberg, MFIF Analysis

Risks

- AMZN partnership does not lead to new customers or increased revenue across the nation as it did in Chicago pilot stores, further depressing revenues
- Turnaround in comparable sales can tighten notes
- Significant improvement in Women's segment as a result of new turnaround strategy can lead to notes tightening
- As with all bonds that hover above high yield, there is a slight fallen angel risk, however we do not foresee this coming to fruition

Figure 9: Competitor Financial Performance and Health

COMPS (\$MM)	KSS	M	JWN	GPS
Market Cap	3.71B	1.92B	2.30B	6.27B
EV	4,169	9,370	7,126	12,308
LTM Revenue	17,292	20,807	12,191	14,054
LTM EBITDA	1,061	466	368	575
LTM EBITDA Margin	6.1%	2.2%	3.0%	4.1%
FCF	673	499	-730	-188
Debt	3,467	4,164	3,942	2,250
Debt/ LTM EBITDA	3.3x	8.9x	10.7x	3.9x
FCF/Debt	19%	12%	-19%	-8%
Individual Secutiry	KSS	M	JWN	GPS
Bond Maturity	7/17/25	6/15/25	5/15/25	5/15/25
Credit Rating	BBB-	BB	BBB-	BB
Price	98.1	103.9	110.3	109.5
Yield	4.700%	6.467%	4.069%	5.085%
Z-Spread	419.9bps	696.9bps	459.0bps	493.1bps
Spread per Turn of Leverage	128.52	77.99	42.84	126.00

*Source: Bloomberg, Company Analysis, MFIF Analysis

Figure 10: Z-Spread



*Source: Bloomberg, Company Analysis, MFIF Analysis

Relative Value

KSS and its comps have traded in relatively similar patterns historically. Though most of its comps' 25s were issued quite recently as opposed to KSS' 25s which were issued in 2016, the trends remain the same. Bonds across the retail industry were trading extremely wide due to market volatility as a result of the Coronavirus pandemic. Slowly however, the market began to price in companies' financial health, growth initiatives, and likelihood of surviving the pandemic, and their spreads began to reflect this. Currently, KSS is trading tighter than its comps by at least ~40bps, we believe this is justified. Qualitatively, KSS' unique partnerships and store format give it a strategic advantage over peers to remain profitable. M & JWN's colossal presence in shopping malls has worked against them in recent months, as many mall-based stores have been forced to permanently close as a result of overall shift by consumers to digital platforms. On Sept. 3, Moody's downgraded JWN's senior unsecured debt ratings to BB+ causing an overall negative sentiment toward the company by investors, leading to increased widening of its 25s. GPS had, for a few weeks, traded tighter to KSS, however as the 2Q results showed continued underperformance of its Banana Republic segment, with drastic declines in same store sales, markets corrected and GPS widened ~180bps.

KSS' credit metrics shed further light on its superior financial position, despite taking out more debt. Its Debt/LTM EBITDA stands at 3.3x while comps M, JWN, and GPS' leverage are 8.9x, 10.7x, and 3.9x respectively. Additionally, KSS' FCF/Debt percentage stands at 19% while its comps are at 12%, -19% and -8% respectively, signifying KSS' superior ability to support its debt obligations using its cash flows when compared to its peers.

The retail industry is a volatile one and this volatility began long before Covid, as the shift to digital commerce has left brick & mortar companies struggling to remain profitable. Covid-19 has exacerbated these challenges. We believe that the market has accurately priced in these risks, while considering KSS' superior ability to emerge from the crisis in a better position than peers.

Figure 11: Summary Model

KOHL'S CORPORATION (NYSE: KSS)											
Fiscal year	2017A	2018A	2019A	1Q20A	2Q20A	3Q20P	4Q20P	2020P	2021P	2022P	2023P
Fiscal year end date	2/3/18	2/2/19	2/1/20	5/2/20	8/1/20	11/30/20	2/28/21	2/28/21	2/28/22	2/28/23	2/29/24
INCOME STATEMENT											
Revenues											
Women's	5,711.0	5,366.0	5,289.0	593.0	951.0	1,087.0	1,575.2	4,206.2	4,708.2	4,896.6	5,043.5
Men's	3,807.0	4,025.0	4,072.0	363.0	657.0	750.4	1,132.8	2,903.2	3,327.9	3,461.0	3,564.9
Home	3,617.0	3,642.0	3,579.0	483.0	598.0	679.3	1,013.8	2,774.0	2,998.8	3,118.8	3,212.3
Children's	2,475.0	2,492.0	2,437.0	269.0	395.0	472.3	698.5	1,834.8	2,070.3	2,153.1	2,217.7
Footwear	1,785.0	1,917.0	1,822.0	233.0	337.0	349.3	545.0	1,464.3	1,591.6	1,655.3	1,704.9
Accessories	1,641.0	1,725.0	1,686.0	219.0	275.0	312.3	476.1	1,282.5	1,398.4	1,454.3	1,497.9
Total Revenue	19,095.0	20,229.0	19,974.0	2,428.0	3,407.0	3,888.4	5,795.8	15,519.1	17,143.4	17,685.4	18,216.0
Cost of Merchandise Sold	(12,176.0)	(12,199.0)	(12,140.0)	(1,787.0)	(2,149.0)	(2,566.3)	(3,825.2)	(10,327.5)	(10,693.4)	(11,318.7)	(11,658.2)
Gross Margin	6,919.0	8,030.0	7,834.0	641.0	1,258.0	1,322.0	1,970.6	5,191.6	6,450.0	6,366.7	6,557.8
Selling, General, and Administrative	(4,512.0)	(5,601.0)	(5,705.0)	(1,066.0)	(1,050.0)	(1,079.7)	(1,609.3)	(4,805.0)	(4,760.2)	(4,950.6)	(5,099.1)
Depreciation and Amortization	(991.0)	(964.0)	(917.0)	(227.0)	(219.0)	(215.2)	(218.8)	(880.0)	(1,017.4)	(838.7)	(885.5)
Operating Profit (EBIT)	1,416.0	1,361.0	1,099.0	(718.0)	118.0	27.2	142.5	(430.4)	672.4	577.4	573.1
Interest Expense, Net	(299.0)	(256.0)	(207.0)	(58.0)	(78.0)	1.2	(69.8)	(204.6)	(138.7)	(160.6)	(160.3)
Income Before Taxes	1,117.0	1,042.0	901.0	(776.0)	40.0	28.4	72.7	(635.0)	533.7	416.8	412.9
Provision for Income Tax	(258.0)	(241.0)	(210.0)	235.0	7.0	7.1	18.2	267.3	133.4	104.2	103.2
Net Income	859.0	801.0	691.0	(541.0)	47.0	35.4	90.8	(367.7)	667.2	521.0	516.1
OPERATING METRICS											
Gross Margin	36.2%	39.7%	39.2%	26.4%	36.9%	34.0%	34.0%	35.0%	36.0%	36.0%	36.0%
SG&A/Sales	(23.6%)	(29.2%)	(30.2%)	(49.4%)	(32.7%)	(29.6%)	(29.6%)	(29.6%)	(29.6%)	(29.6%)	(29.6%)
Operating Margin	7.4%	6.7%	5.5%	(29.6%)	3.5%	0.7%	2.5%	(2.8%)	3.9%	3.3%	3.1%
Tax Rate	23.1%	23.1%	23.3%	30.3%	(17.5%)	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
EBITDA RECONCILIATION											
Net Income	859.0	801.0	691.0	(541.0)	47.0	35.4	90.8	(367.7)	667.2	521.0	516.1
(+) Interest	(299.0)	(256.0)	(207.0)	(58.0)	(78.0)	1.2	(69.8)	(204.6)	(138.7)	(160.6)	(160.3)
(+) Taxes	(258.0)	(241.0)	(210.0)	235.0	7.0	7.1	18.2	267.3	133.4	104.2	103.2
(+) Depreciation & Amortization	(991.0)	(964.0)	(917.0)	(227.0)	(219.0)	(215.2)	(218.8)	(880.0)	(1,017.4)	(838.7)	(885.5)
EBITDA	2,407.0	2,262.0	2,025.0	(491.0)	337.0	242.4	361.3	449.6	1,689.8	1,416.1	1,458.6
(+) Stock Based Compensation	55.0	87.0	56.0	15.0	(1.0)	16.8	7.6	43.5	48.1	49.6	51.1
Adj. EBITDA	2,462.0	2,349.0	2,081.0	(476.0)	336.0	259.2	368.9	493.1	1,737.9	1,465.7	1,509.7
FCF RECONCILIATION											
Cash Flow From Operations	1,691.0	2,107.0	1,657.0	53.0	251.0	927.9	463.5	1,695.3	629.3	1,798.0	1,138.8
(-) CapEx	(672.0)	(578.0)	(855.0)	(162.0)	(34.0)	(27.0)	(27.0)	(250.0)	(650.0)	(670.5)	(690.7)
FCF	2,363.0	2,685.0	2,512.0	215.0	285.0	954.9	490.5	1,945.3	1,279.3	2,468.5	1,829.4
CREDIT METRICS											
Debt	2,797.0	1,861.0	1,856.0	3,449.0	3,450.0	3,467.0	3,467.0	3,467.0	3,467.0	3,467.0	3,467.0
Debt/EBITDA	1.2x	0.8x	0.9x	2.9x	3.8x	4.8x	7.7x	7.7x	2.1x	2.4x	2.4x
EBITDA/Interest	8.1x	8.8x	9.8x	5.6x	3.9x	3.9x	2.2x	2.2x	12.2x	8.8x	9.1x

*Source: MFIF Analysis, SEC Filings