KOHL'S CORPORATION (NYSE: KSS) – Greg Blotnick – 12/1/2014

KOHL'S CORP (NYSE:KSS) 11/24/2014

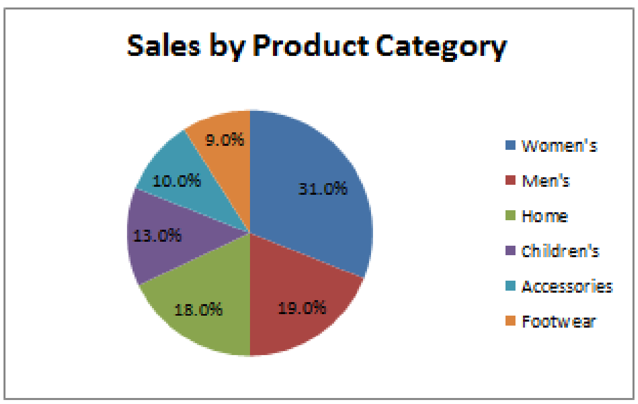
Summary Financials - Base Case:

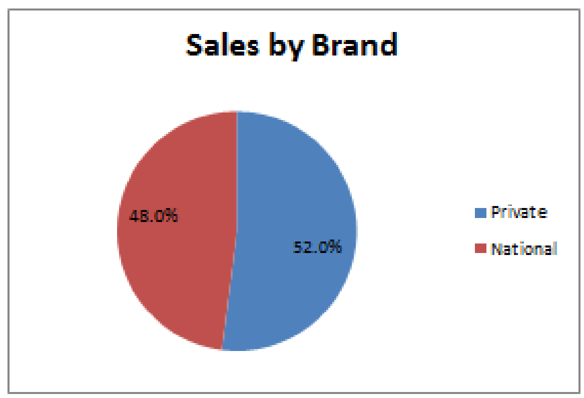
Currency: $m except per share data		Nov14E
Current Price as of:	11/24/2014	$58.92
Shares Outstanding		204.6
=Market Capitalization		**$12,055**
-Cash & Short Term Investments		$746.0
+Total Debt		$4,793.0
=Total Enterprise Value		**$16,102.0**
Book Value of Common Equity		$5,809.0
+Total Debt		$4,793.0
=Total Capital		**$10,602.0**
Liquidity:		
Net Debt / EBITDA		1.6x
EBITDA / Interest Expense		7.6x

Summary Financials	FY10A	FY11A	FY12A	FY13A	FY14A	FY15E	FY16E	FY17E
Total Revenues	**$ 17,178.0**	**$ 18,391.0**	**$ 18,804.0**	**$ 19,279.0**	**$ 19,031.0**	**$ 18,935.8**	**$ 18,935.8**	**$18,935.8**
Growth y/y%		*7.1%*	*2.2%*	*2.5%*	*-0.5%*	*0.0%*	*0.0%*	*0.0%*
Street Revenues (Nov14)						$18,904.8	$19,193.7	$19,532.9
Operating Income	$1,859.0	$2,092.0	$2,158.0	$1,890.0	$1,742.0	$1,647.4	$1,571.7	$1,514.9
Margin %	*10.8%*	*11.4%*	*11.5%*	*9.8%*	*9.2%*	*8.7%*	*8.3%*	*8.0%*
Free Cash Flow	$1,611.0	$949.0	$1,212.0	$480.0	$1,241.0	$1,056.7	$974.8	$913.4
Margin %	*9.4%*	*5.2%*	*6.4%*	*2.5%*	*6.5%*	*5.6%*	*5.1%*	*4.8%*
EPS	**$ 3.15**	**$ 3.66**	**$ 4.31**	**$ 4.16**	**$ 4.04**	**$ 4.11**	**$ 4.08**	**$ 4.11**
EPS Growth y/y%		16.3%	17.7%	-3.4%	-2.9%	1.8%	-0.8%	0.7%
Street EPS (Nov14)	n/a	n/a	n/a	n/a	n/a	$4.08	$4.53	$5.01
EV / EBITDA	n/a	n/a	n/a	n/a	6.1x	6.4x	6.6x	6.8x
EV / FCF	n/a	n/a	n/a	n/a	13.0x	15.2x	16.5x	17.6x
EV / Sales	n/a	n/a	n/a	n/a	0.8x	0.9x	0.9x	0.9x
P / E	n/a	n/a	n/a	n/a	14.6x	14.3x	14.5x	14.4x
FCF / Share	n/a	n/a	n/a	n/a	$6.07	$5.16	$4.76	$4.46
FCF Yield %	n/a	n/a	n/a	n/a	10.3%	8.8%	8.1%	7.6%

Business Overview:

Kohl's Corporation operates department stores in the United States. It offers exclusive and national brand apparel, footwear, accessories, beauty, and soft home products to children, men, and women customers. As of February 1, 2014, it operated 1,158 family-oriented department stores and a Website, Kohls.com. Kohl's Corporation was founded in 1962 and is headquartered in Menomonee Falls, Wisconsin.





Investment Thesis:

KSS is a **SHORT** because:

- Kohl's is optically cheap, with a 10% FCF yield and 2.7% dividend yield, but these ratios are misleading given that comps are declining, margins are eroding, and EPS growth has been driven by unsustainable factors (buybacks, cost cuts)
- KSS has no competitive advantages while operating in an intensely competitive, secularly declining industry; donating market share over the years to TJX/ROST as well as M/JWN.
- Management is putting band-aids over tumors with "reactive" and margin-dilutive initiatives (loyalty, beauty, national brands, E-commerce) rather than proactive ones that differentiate them from competitors
- **As a result, I expect revenues and EPS to grow to $18.9B and $4.11, respectively, compared to consensus revenues of $19.5B and EPS of $5.01 by 2017.**

How this plays out?

- Kohl's new turnaround initiatives, dubbed "The Greatness Agenda," will prove unsustainable and fail to stimulate top-line growth. As a result, EBIT will continue to decline to $1.51B by 2017, and free cash flow will shrink to $913m by 2017 thus causing Kohl's to miss both short-term and long-term consensus estimates (2015E revenues of $18.9B and EBIT of $1.67B, and 2017E revenues of $19.5B and EBIT of $1.75B).
- The decline in free cash flow will also cause Kohl to reduce buybacks and cut their dividend, resulting in multiple compression.

Bull/Bear Debate:

- **The bulls** believe that new management initiatives will accelerate comps (2%+) both in 4Q and beyond; thus, enabling management to meet or exceed their FY14 guidance ($4.05-4.45 in EPS)
- **The bears** believe management's forward guidance is aggressive and unwarranted given both industry headwinds and recent company-specific comp trends. KSS is in structural decline, with EBIT declining at an alarming rate (-10% CAGR over fiscal years 2012-2013). Declines in free cash flow will put future buybacks at risk.

My view:

- Kohl's has lost its relevance amongst department stores and lacks differentiation, and unit economics are in decline as consumers are heading elsewhere.
- Despite EBITDA collapsing over the years, along with slowing comps and eroding margins, Kohl's share price has been relatively stable as a result of management buying back nearly 40% of the float, which is unsustainable.
- The department store industry is saturated and shrinking, and weaker players like KSS and JCP are losing market share to high-quality players (M/JWN) or heading to off-price retailers like TJX/ROST.
- Management has rolled out a five-pillar plan titled the "Greatness Agenda" which they hope will bring the customer back. I believe each of these initiatives is reactive rather than proactive and likely to fail.
- As a result, revenues and earnings will come in below consensus estimates, along with KSS' multiple compressing.

Probability Weighted Price Target:

- Target of $38.73 implies 31% downside from current prices, with base case revenues and EPS largely flat combined with margin pressure and negative comps.

Probable Scenarios		FY17E	Forward P/E	Price	Return	Revenue CAGR	EPS CAGR	Probability	2016 Price Target	Return %
Case 1: Negative comps, severe margin degradation, no buyback	$	2.93	6x	$17.57	-69%	-1.7%	-9.6%	10%	$38.73	-31%
Case 2: Negative comps, severe margin degradation, 5m buyback	$	3.76	8x	$30.11	-47%	-0.7%	-2.7%	30%		
Case 3: Comps down small, 10m buyback	$	4.11	10x	$41.05	-27%	0.0%	-0.1%	40%		
Case 4: Flat comps, 10m buyback	$	4.39	12x	$52.64	-7%	0.0%	1.1%	15%		
Case 5: Positive comps, stable margins, 15m buyback	$	5.57	13x	$72.45	28%	0.7%	6.6%	5%		

Risks:

- Strong consumer spending causes industry headwinds to be weaker than expected benefiting department stores
- KSS is able to sign "big-name" national brands that lead to traffic returning

Timeline – Key Events

- February 2015; Q4 earnings release

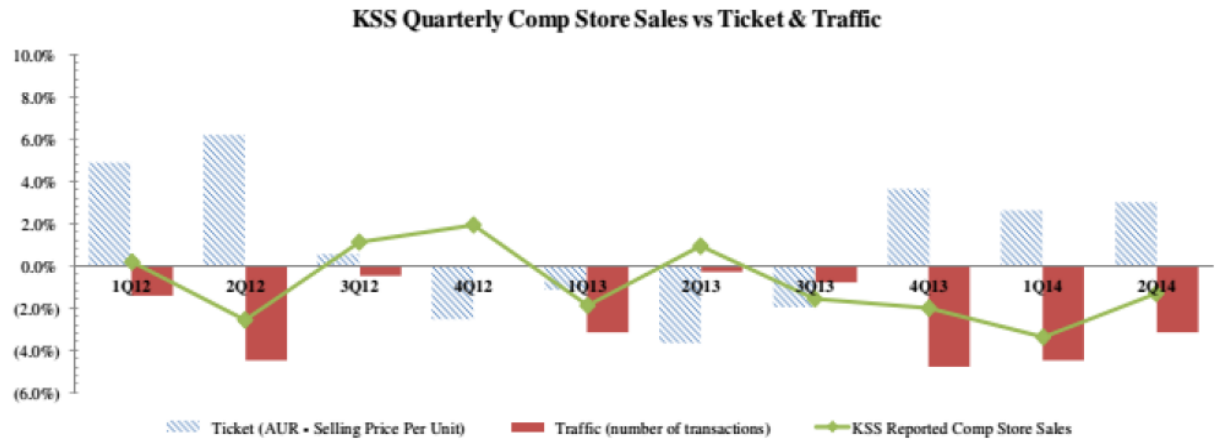
Financials – Base Case

KSS - Base Case #3

Income Statement	2010A	2011A	2012A	2013A	2014A	2015E	2016E	2017E
Total Stores	1058	1089	1127	1146	1158	1158	1158	1158
Same Store Sales Growth	0.4%	4.4%	0.5%	0.3%	(1.2%)	-0.5%	0.0%	0.0%
Total Revenues	**17,178.0**	**18,391.0**	**18,804.0**	**19,279.0**	**19,031.0**	**$18,936**	**$18,936**	**$18,936**
Growth y/y%	*5.1%*	*7.1%*	*2.2%*	*2.5%*	*-1.3%*	*-0.5%*	*0.0%*	*0.0%*
Street Revenues						$18,904.80	$19,193.70	$19,532.90
Cost of Goods Sold	10,680.0	11,359.0	11,625.0	12,289.0	12,087.0	$12,119	$12,176	$12,214
Gross Profit	**$6,498**	**$7,032**	**$7,179**	**$6,990**	**$6,944**	**$6,817**	**$6,760**	**$6,722**
Gross Margin %	*37.8%*	*38.2%*	*38.2%*	*36.3%*	*36.5%*	*36.0%*	*35.7%*	*35.5%*
SG&A	3,951.0	4,190.0	4,243.0	4,267.0	4,313.0	$4,317.37	$4,336.31	$4,355.24
as % of Revenues	*23.0%*	*22.8%*	*22.6%*	*22.1%*	*22.7%*	*22.8%*	*22.9%*	*23.0%*
D&A	688.0	750.0	778.0	833.0	889.0	$852	$852	$852
as % of Revenues	*4.0%*	*4.1%*	*4.1%*	*4.3%*	*4.7%*	*4.5%*	*4.5%*	*4.5%*
Total Operating Expenses	4,639.0	4,940.0	5,021.0	5,100.0	5,202.0	5,169.5	5,188.4	5,207.4
EBIT	**$1,859**	**$2,092**	**$2,158**	**$1,890**	**$1,742**	**$1,647**	**$1,572**	**$1,515**
Growth y/y%		*12.5%*	*3.2%*	*-12.4%*	*-7.8%*	*-5.4%*	*-4.6%*	*-3.6%*
EBIT Margin %	*10.8%*	*11.4%*	*11.5%*	*9.8%*	*9.2%*	*8.7%*	*8.3%*	*8.0%*
Operating Leverage %		**19.2%**	**16.0%**	**-56.4%**	**59.7%**	**0.0%**	**0.0%**	**0.0%**
EBITDA	**$2,547**	**$2,842**	**$2,936**	**$2,723**	**$2,631**	**$2,500**	**$2,424**	**$2,367**
EBITDA Margin	*14.8%*	*15.5%*	*15.6%*	*14.1%*	*13.8%*	*13.2%*	*12.8%*	*12.5%*
Net Interest Expense	(311.00)	(304.00)	(299.00)	(329.00)	(338.00)	(342.00)	(342.00)	(342.00)
Taxes	585.0	668.0	692.0	575.0	515.0	483	455	434
Effective Tax Rate %	*37.8%*	*37.4%*	*37.2%*	*36.8%*	*36.7%*	*37.0%*	*37.0%*	*37.0%*
Net Income	**$ 963**	**$ 1,120**	**$ 1,167**	**$ 986**	**$ 889**	**$ 822**	**$ 775**	**$ 739**
Net Income Margin %	*5.6%*	*6.1%*	*6.2%*	*5.1%*	*4.7%*	*4.3%*	*4.1%*	*3.9%*
Diluted Shares Outstanding	306.0	306.0	271.0	237.0	220.0	200.00	190.00	180.00
Diluted EPS	**$ 3.15**	**$ 3.66**	**$ 4.31**	**$ 4.16**	**$ 4.04**	**$ 4.11**	**$ 4.08**	**$ 4.11**
Growth y/y%		*16.3%*	*17.7%*	*-3.4%*	*-2.9%*	*-1.2%*	*-0.8%*	*0.7%*
Street EPS						$4.08	$4.53	$5.01
Dividends Per Share	0	0	$1.0	$1.28	$1.4	$1.40	$1.53	$1.68
Growth y/y%				*28.0%*	*9.4%*	*9.4%*	*9.4%*	*9.4%*
Total Dividends Paid			(273.0)	(303.0)	(305.0)	($280)	($291)	($302)
Share Repurchases	50	($929.0)	($2,253.0)	($1,225.0)	($710.0)	(1,178)	(589)	(589)
CFFO	**2,286.0**	**1,750.0**	**2,139.0**	**1,265.0**	**1,884.0**	**$ 1,782**	**$ 1,700**	**$ 1,638**
Capex	(675.0)	(801.0)	(927.0)	(785.0)	(643.0)	(725)	(725)	(725)
Free Cash Flow	**1,611**	**949**	**1,212**	**480**	**1,241**	**1,057**	**975**	**913**
Growth y/y%		*-41.1%*	*27.7%*	*-60.4%*	*158.5%*	*120.1%*	*-7.8%*	*-6.3%*
FCF/Share	**5.26**	**3.10**	**4.47**	**2.03**	**5.64**	**5.28**	**5.13**	**5.07**
FCF Margin %	*9.4%*	*5.2%*	*6.4%*	*2.5%*	*6.5%*	*5.6%*	*5.1%*	*4.8%*
Capex as % of Revenue	*3.9%*	*4.4%*	*4.9%*	*4.1%*	*3.4%*	*3.8%*	*3.8%*	*3.8%*
Capex / D&A	*0.98*	*1.07*	*1.19*	*0.94*	*0.72*	*0.85*	*0.85*	*0.85*

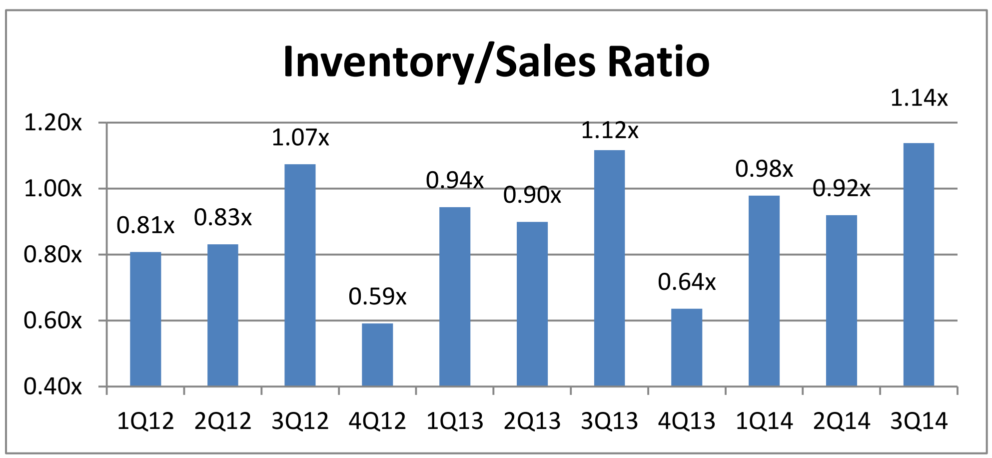
Balance Sheet	2010A	2011A	2012A	2013A	2014A	2015E	2016E	2017E
Cash & Equivalents	2,267	2,277	1,205	537	971	971	971	971
Net Working Capital	3,030	2,861	2,222	2,184	2,556	2,642	2,642	2,642
NWC as % of Revenue	*17.6%*	*15.6%*	*11.8%*	*11.3%*	*13.4%*	*14.0%*	*14.0%*	*14.0%*
Net PP&E	8,506.0	8,692.0	8,905.0	8,872.0	8,745.0	8,618	8,491	8,364
Net Operating Assets	**11,536**	**11,553**	**11,127**	**11,056**	**11,301**	**11,260**	**11,133**	**11,006**
NOPAT (EBIT * (1-t))	**2,444**	**2,760**	**2,850**	**2,465**	**2,257**	**2,130**	**2,027**	**1,949**
RNOA %	*21.2%*	*23.9%*	*25.6%*	*22.3%*	*20.0%*	*18.9%*	*18.2%*	*17.7%*
Debt	3,940.0	3,998.0	4,244.0	4,553.0	4,861.0	4,553	4,553	4,553
Equity	7,595.0	7,850.0	6,508.0	6,048.0	5,978.0	5,972	6,449	6,900
Less: Cash	2,267	2,277	1,205	537	971	971	971	971
Total Capital	**9,268**	**9,571**	**9,547**	**10,064**	**9,868**	**9,554**	**10,031**	**10,482**
ROIC %	***26.4%***	***28.8%***	***29.9%***	***24.5%***	***22.9%***	***22.3%***	***20.2%***	***18.6%***

Kohl's has been subject to weakening unit economics as a result of slowing traffic

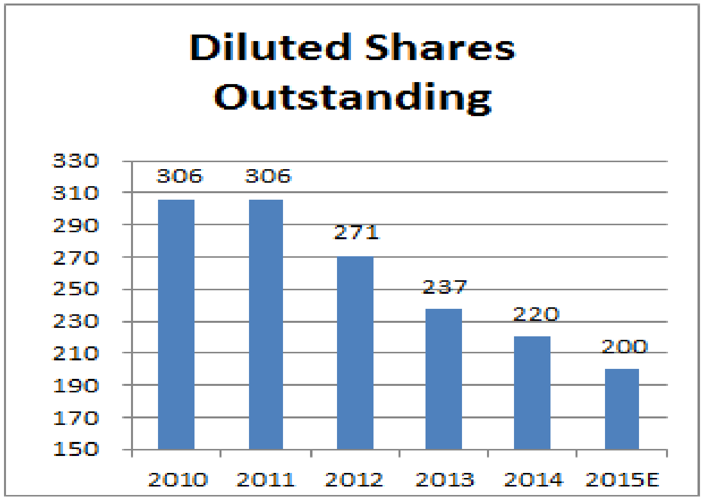


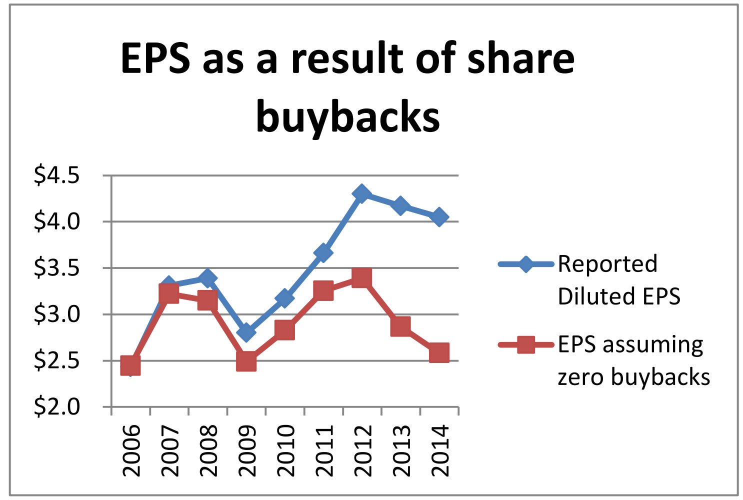
Above: Traffic and AUR have both been declining as consumers leave Kohl's for high-end department stores like Macy's or Nordstrom, or trade down to off-price retailers like TJX/ROST. AUR staged a bounce as new national brands were introduced, but traffic is still poor and must return for Kohl's to accelerate comp growth.

- Kohl's is stuck in retail "no-man's land" along with J.C. Penney; more expensive than off-price retailers like TJX or Ross Stores, but lower quality than Macy's or Nordstrom.
  - Former Kohl's employees indicate that Kohl's has **"lost its identity; other stores like Macy's have gotten younger and invested heavily in omni-channel, and Kohl's is now playing catch-up."**
  - Kohl's has noted they feel the pinch when ROST/TJX enter their legacy states (Midwest): The off-price store when they open **is a hit and certainly, given their outsized growth over the last year -- the last few years has hurt our comps, especially as some of the competitors like Ross come to the Midwest areas where they haven't really concentrated before…They tend to grow faster than the rest of us do in the industry. So I expect it to be somewhat of a headwind."**
  - This competitive pressure will result in aggressive promotions in FY15 to deal with inventory build-up, further straining margins.

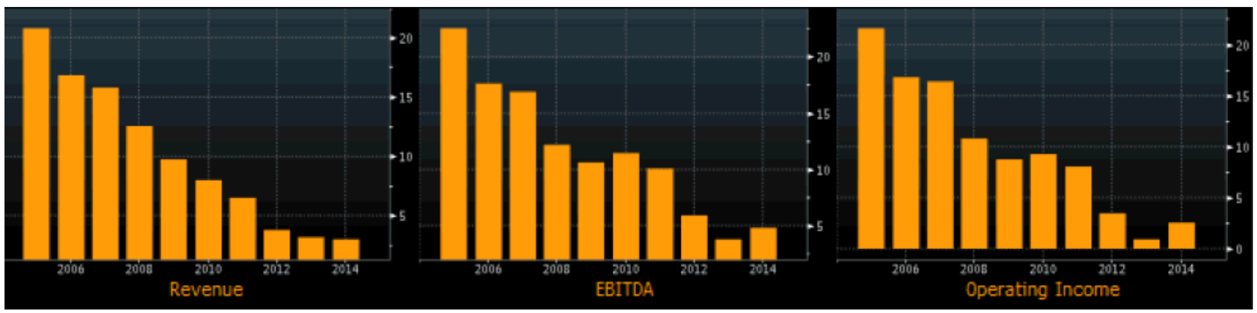


Despite poor fundamentals, Kohl's stock has stayed afloat due to financial engineering

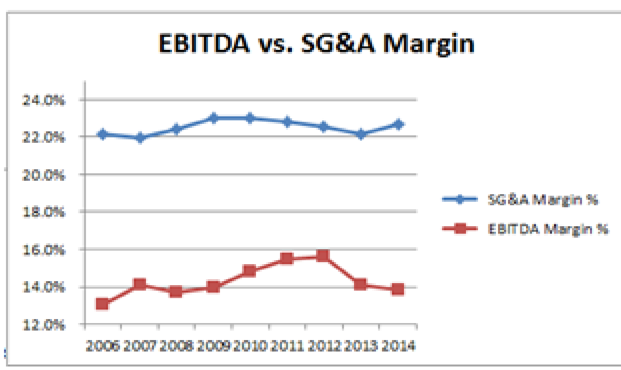




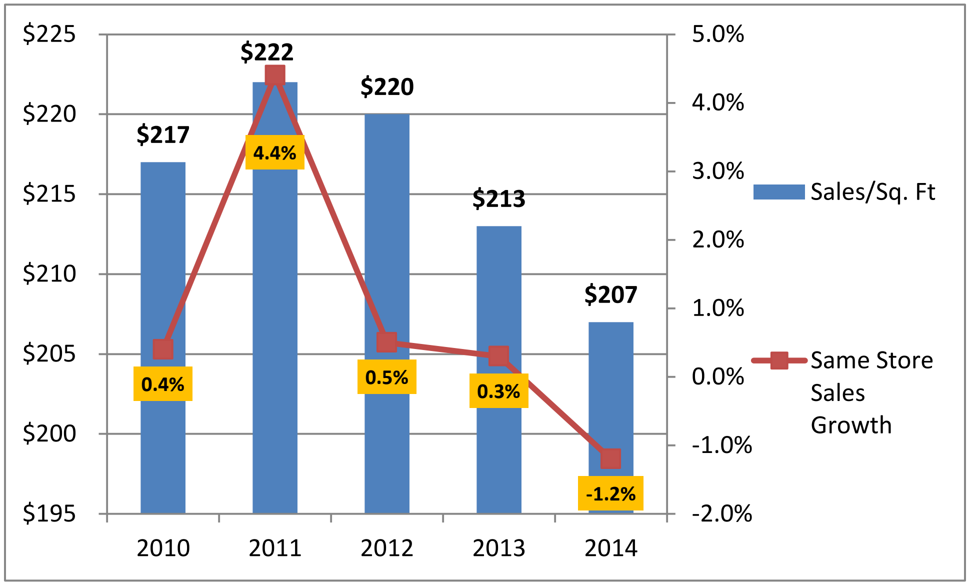
- These massive buybacks serve to mask the fact that top-line, EBITDA, and operating income have all collapsed over the past ten years:

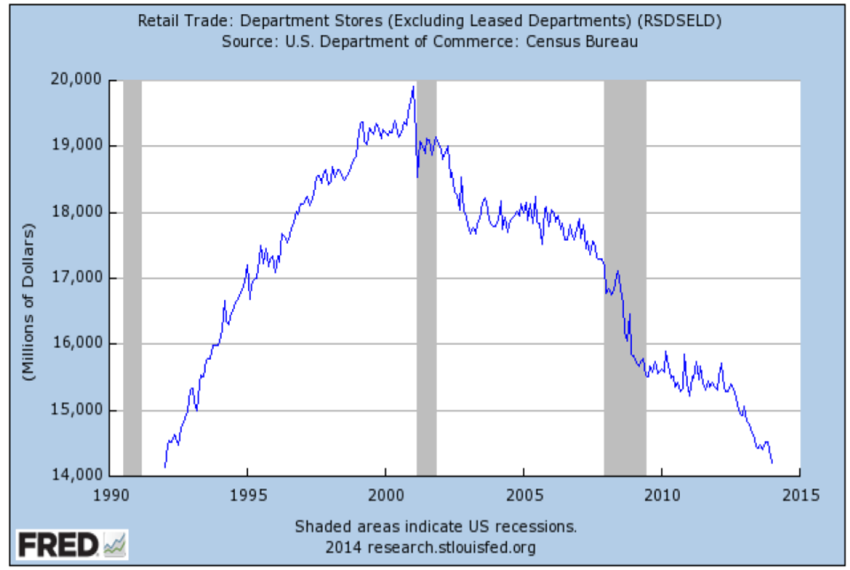


- EPS growth has also been driven by strong SG&A management, but cost-cutting is not a sustainable source of growth, and EBITDA margins have been declining in recent years. As traffic has slowed, inventory turnover has been in free-fall.



The department store industry is in structural decline and weak players like Kohl's are losing share



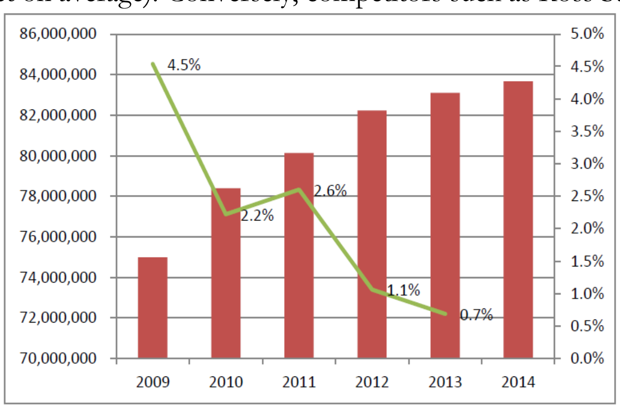


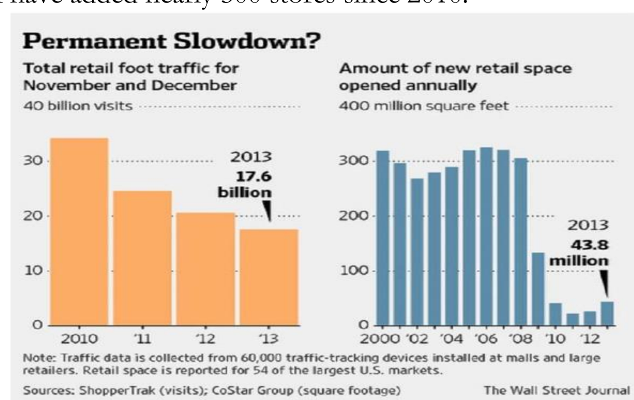
KSS' Sales per square foot have dropped rapidly due to increased competition

Aggregate department store sales have fallen from ~$19B in 2001 to near $14B today

- IBISWorld's 2014 "Department Stores in the United States" report supports this conclusion, stating that "intense price-based competition will lead to industry declines, despite an improving economy."
  - **"Heightened competition from online retailers has limited industry demand despite increased consumer spending. The Department Stores industry will continue contracting over the five years to 2019, albeit a slower rate. Growing competition from online retailers is expected to place further price pressures on industry operators.**
- Kohl's also has had stagnant square footage growth in recent years, with no room for unit growth to leverage high fixed costs (stores are over 70,000 square feet on average). Conversely, competitors such as Ross Stores and TJX have added nearly 500 stores since 2010.

Right: total square footage & rate of sq. footage growth





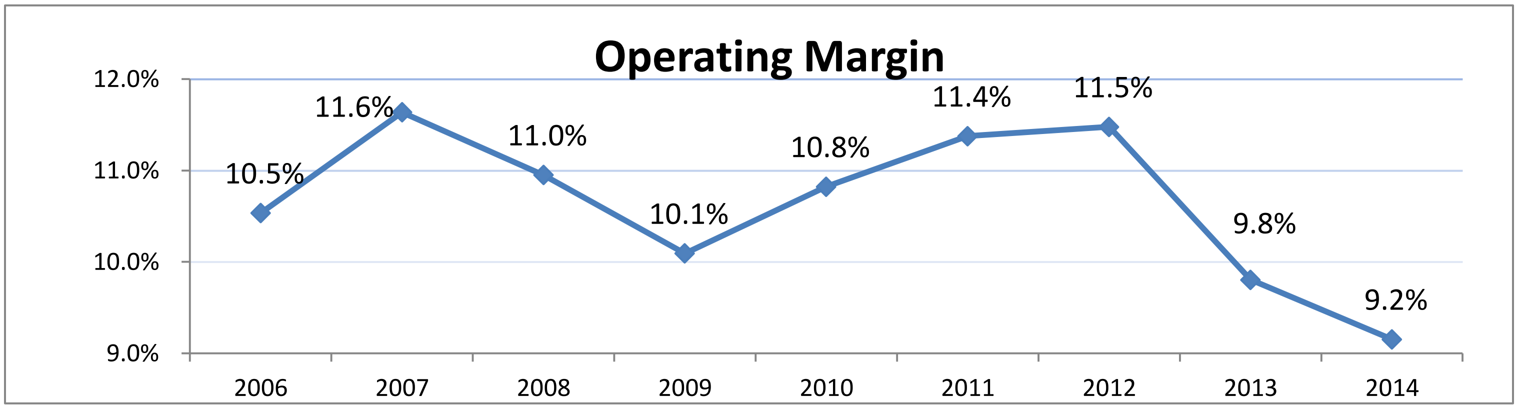
Management has introduced a handful of initiatives intended to accelerate SSS growth

- One pillar of management's "Greatness Agenda" rests on bringing in exciting new national brands to draw traffic.
  - So far, Kohl's has signed deals with Juicy Couture and Izod. I believe that these brands are undesirable and out-of-fashion, and will fail to draw traffic. Sell-side analysts agree, with JPM saying: "Bigger picture, we are optimistic that KSS management is moving in the right direction strategically, **but are concerned that the problems plaguing business today may be more macro and structural (consumer preferring better/high-end brands and off-price shopping concepts) which could undermine initiatives.**

- IZOD and Juicy Couture, the two national brands that management are hoping will bring the customer back to Kohl's, are seen as undesirable based on conversations with ex-employees.
  - "Both brands are from five years ago. No one goes to a store to buy Juicy Couture anymore."
  - "The fact that Juicy is being sold at Kohl's is a new low for Juicy. No idea if this is seen by Kohl's management is a big win for them. I can guarantee that these aren't stocked in Macy's or Nordstrom. There's no way it would sell-through."
  - **The only reason Kohl's was able to get an exclusive deal with Juicy in the first place was because every other department store passed on them or dumped the brand:** New York Magazine notes below that many retailers viewed the brand as "stale," and that everyone from Neiman Marcus to Saks to Bergdorf cut back or dropped the line entirely:
  - IZOD, in addition to being panned by our contacts in the fashion industry, is being sold at steep markdowns on various websites.
    - Below, men's apparel is 55% off, plus an extra 15% off, plus $10 off purchases over $50, plus free shipping over $75, and 4% cash back to sweeten the deal. It's difficult to believe Kohl's can turn a profit on these items once shipping costs and continued e-commerce capex are factored in.

These initiatives as a whole are margin-dilutive as well as unsustainable drivers of growth

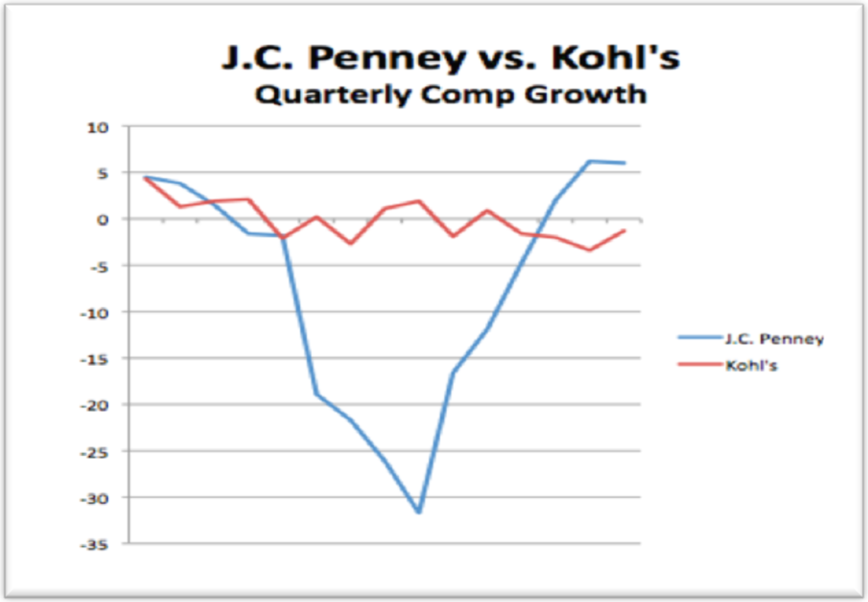
- Kohl's new loyalty program as well as beauty/E-commerce rollouts may provide a temporary lift to comps, but these are not sustainable drivers of top-line growth.
  - Loyalty has been a feature at other competitors (Macy's, Nordstrom) for years and KSS is simply playing catch-up. As noted, with no differentiation in items stocked versus competitors, Kohl's attempt to "connect with their customer" is not the way to fix this company.
    - Kohl's loyalty program, titled "Kohl's Cash," is highly promotional in nature, with our contacts indicating that **"…we are giving Kohl's cash for the majority of items purchased…typically you buy $50 of goods for a $10 card, or a $25 card for $100 spent."** These will be dilutive to margins as a result.
  - The beauty program is an attempt to capitalize on the same success JCP has enjoyed with Sephora, but without the brand name to draw traffic.
    - I believe Kohl's beauty program may provide a successful 1-2% lift in comps near-term, but will fade longer-term as the novelty wears off.
  - E-commerce, while growing at a rapid clip (20-30%), is likely to cannibalize Kohl's sales and carries lower margins. Additionally, the e-commerce rollout requires incremental capex and will put a damper on KSS' prized free cash flow yield.
    - Industry experts have indicated that operating margins on e-commerce goods for Kohl's are in the low single digits versus comps compared to ~10% in stores, due to the fact that basket sizes are smaller than Nordstrom's or Macy's along with shipping cost pressure.



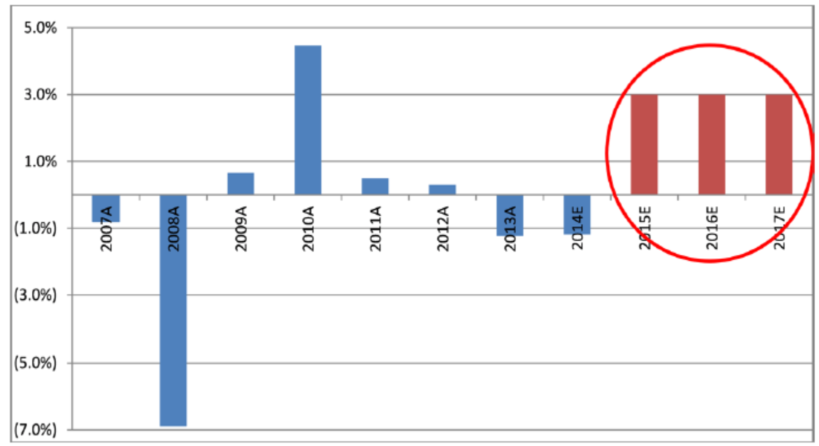
- Management does not have the ability to execute on a national brand roll-out, given prior focus on private label.
  - In addition to inevitable margin pressure, management has stated they are still "learning" how to market new brands (Q3 call): "Juicy performed exceptionally well in certain parts of the country and as expected, not quite as well in other parts. From a classification perspective, it outperformed in some categories, for instance, footwear or handbag, in particular. **And the rest of the business is we're learning."**
  - Any comp lift has proven to be temporary thus far; "Not surprisingly, during September when business was better, those 2 brands both performed better. And then in October, when traffic slowed, relatively those 2 brands didn't perform as well as they did during September."

Management has had a hard time meeting analyst estimates for years, yet gave aggressive FY17 guidance

- Management has done a poor job as they failed to adapt to industry changes like M/JWN, and were somehow unable to steal share in the midst of J.C. Penney comping -31% y/y (below):



Below: management's long-term guide implies 3% same-store sales growth through 2017 when management has only achieved this once in the past seven years



  - I believe CEO Kevin Mansell is on his way out for multiple reasons. The company started its search for a Chief Merchandising Officer in March, after the prior officer Donald Brennan unexpectedly departed. The new hire is expected to be groomed as Mansell's successor; this was supposed to be resolved by Kohl's analyst day in October.
    - After there was still no hire at the analyst day, Mansell was asked about the departure on the 3Q'14 earnings call. Mansell responded with: **"No, no, no update on our search. We're still focused on it. Obviously, it's a key focus of mine, but no update since a couple of weeks ago at the investor conference."**

- **While it is possible new management could turn the company around, the more likely scenario is that the bear thesis will start playing out as soon as February 2015. Current management stopped giving quarterly guidance six months ago after having provided it for years, signaling a lack of visibility going forward. In addition, they also introduced an aggressive three-year plan (below) implying drastic acceleration of comps (3% y/y despite flat-to-down since 2010). Kohl's management has backed themselves into a corner by not lowering FY'14 guidance and will struggle to make the low end of their EPS forecast ($4.05 to $4.45 per share).**

Kohl's will miss both short-term and long-term earnings estimates, leading to multiple compression

- Regardless of how 4Q/FY14 play out, there is a strong likelihood of slowing comps, degradation, and limited buybacks over the next three years as free cash flow slows.
  - As a result, Kohl's will be forced to slow the pace of share repurchases and/or cut their dividend

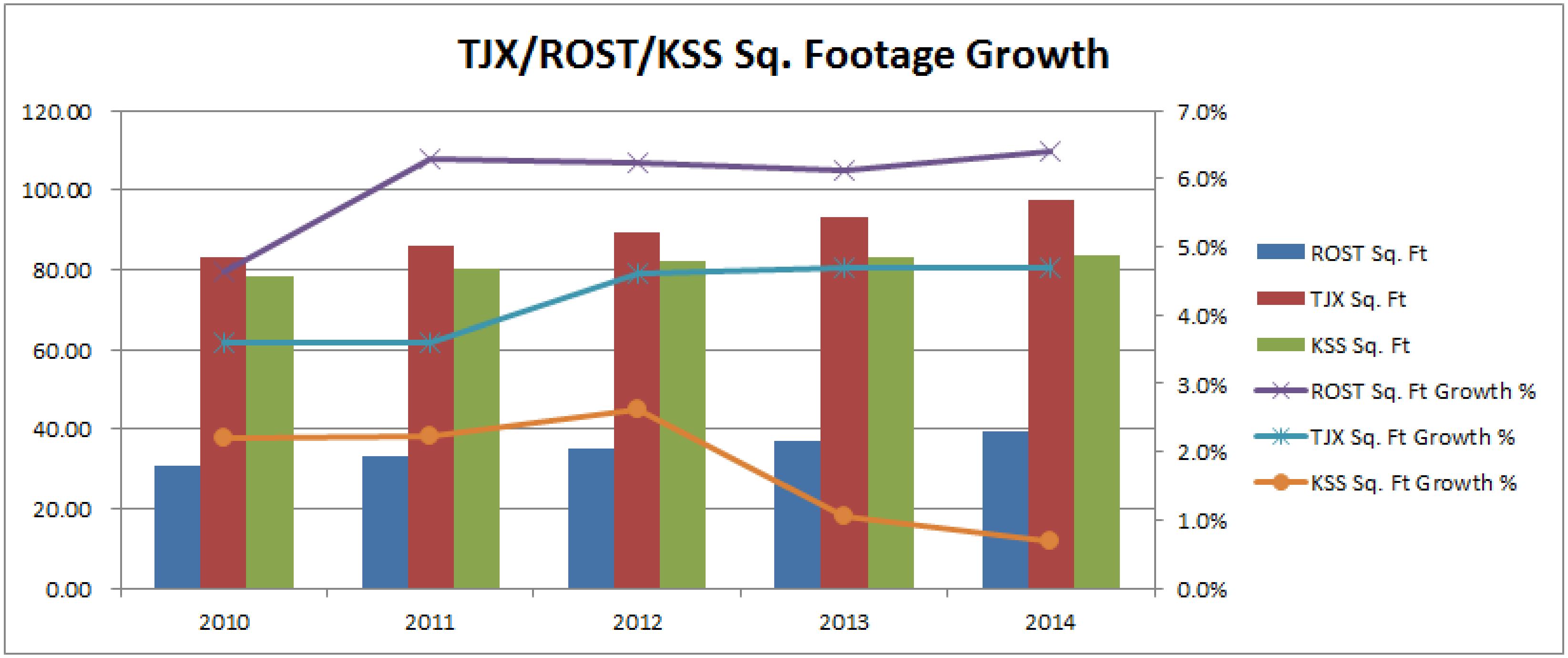
- My base case estimates suggest flat comps and EBIT margin compression of 120 bps, with EPS barely growing over the same period (1% CAGR)
  - Kohl's multiple compresses over the same period to 10x, implying a -30% return on FY17 EPS of $4.11

Currency: $m	FY10A	FY11A	FY12A	FY13A	FY14A	FY15E	FY16E	FY17E
Case 1: Negative comps, severe margin degradation, no buyback								
Revenue	$ 17,178	$ 18,391	$ 18,804	$19,279	$ 19,031	$ 18,841	$ 18,464	$ 17,910
Growth %	*0.0%*	*7.1%*	*2.2%*	*2.5%*	*-0.5%*	*-1.0%*	*-2.0%*	*-3.0%*
EBIT	$1,859	$2,092	$2,158	$1,890	$1,742	$1,601	$1,440	$1,272
EBIT Margin %	*10.8%*	*11.4%*	*11.5%*	*9.8%*	*9.2%*	*8.5%*	*7.8%*	*7.1%*
EPS	$ 3.15	$ 3.66	$ 4.31	$ 4.16	$ 4.04	$ 3.97	$ 3.46	$ 2.93
Growth %	*0.0%*	*16.3%*	*17.7%*	*-3.4%*	*-2.9%*	*-4.6%*	*-12.6%*	*-15.4%*
Case 2: Negative comps, severe margin degradation, 5m buyback								
Revenue	$ 17,178	$ 18,391	$ 18,804	$19,279	$ 19,031	$ 18,841	$ 18,652	$ 18,466
Growth %	*0.0%*	*7.1%*	*2.2%*	*2.5%*	*-0.5%*	*-1.0%*	*-1.0%*	*-1.0%*
EBIT	$1,859	$2,092	$2,158	$1,890	$1,742	$1,639	$1,548	$1,477
EBIT Margin %	*10.8%*	*11.4%*	*11.5%*	*9.8%*	*9.2%*	*8.7%*	*8.3%*	*8.0%*
EPS	$ 3.15	$ 3.66	$ 4.31	$ 4.16	$ 4.04	$ 4.09	$ 3.90	$ 3.76
Growth %	*0.0%*	*16.3%*	*17.7%*	*-3.4%*	*-2.9%*	*-1.6%*	*-4.6%*	*-3.4%*
Case 3: Comps down small, 10m buyback								
Revenue	$ 17,178	$ 18,391	$ 18,804	$19,279	$ 19,031	$ 18,936	$ 18,936	$ 18,936
Growth %	*0.0%*	*7.1%*	*2.2%*	*2.5%*	*-0.5%*	*0.0%*	*0.0%*	*0.0%*
EBIT	$1,859	$2,092	$2,158	$1,890	$1,742	$1,647	$1,572	$1,515
EBIT Margin %	*10.8%*	*11.4%*	*11.5%*	*9.8%*	*9.2%*	*8.7%*	*8.3%*	*8.0%*
EPS	$ 3.15	$ 3.66	$ 4.31	$ 4.16	$ 4.04	$ 4.11	$ 4.08	$ 4.11
Growth %	*0.0%*	*16.3%*	*17.7%*	*-3.4%*	*-2.9%*	*1.8%*	*-0.8%*	*0.7%*
Case 4: Flat comps, 10m buyback								
Revenue	$ 17,178	$ 18,391	$ 18,804	$19,279	$ 19,031	$ 19,031	$ 19,031	$ 19,031
Growth %	*0.0%*	*7.1%*	*2.2%*	*2.5%*	*-0.5%*	*0.0%*	*0.0%*	*0.0%*
EBIT	$1,859	$2,092	$2,158	$1,890	$1,742	$1,656	$1,599	$1,561
EBIT Margin %	*10.8%*	*11.4%*	*11.5%*	*9.8%*	*9.2%*	*8.7%*	*8.4%*	*8.2%*
EPS	$ 3.15	$ 3.66	$ 4.31	$ 4.16	$ 4.04	$ 4.24	$ 4.28	$ 4.39
Growth %	*0.0%*	*16.3%*	*17.7%*	*-3.4%*	*-2.9%*	*2.0%*	*0.8%*	*2.5%*
Case 5: Positive comps, stable margins, 15m buyback								
Revenue	$ 17,178	$ 18,391	$ 18,804	$19,279	$ 19,031	$ 19,221	$ 19,414	$ 19,608
Growth %	*0.0%*	*7.1%*	*2.2%*	*2.5%*	*-0.5%*	*1.0%*	*1.0%*	*1.0%*
EBIT	$1,859	$2,092	$2,158	$1,890	$1,742	$1,766	$1,784	$1,802
EBIT Margin %	*10.8%*	*11.4%*	*11.5%*	*9.8%*	*9.2%*	*9.2%*	*9.2%*	*9.2%*
EPS	$ 3.15	$ 3.66	$ 4.31	$ 4.16	$ 4.04	$ 4.60	$ 5.05	$ 5.57
Growth %	*0.0%*	*16.3%*	*17.7%*	*-3.4%*	*-2.9%*	*10.6%*	*9.7%*	*10.4%*

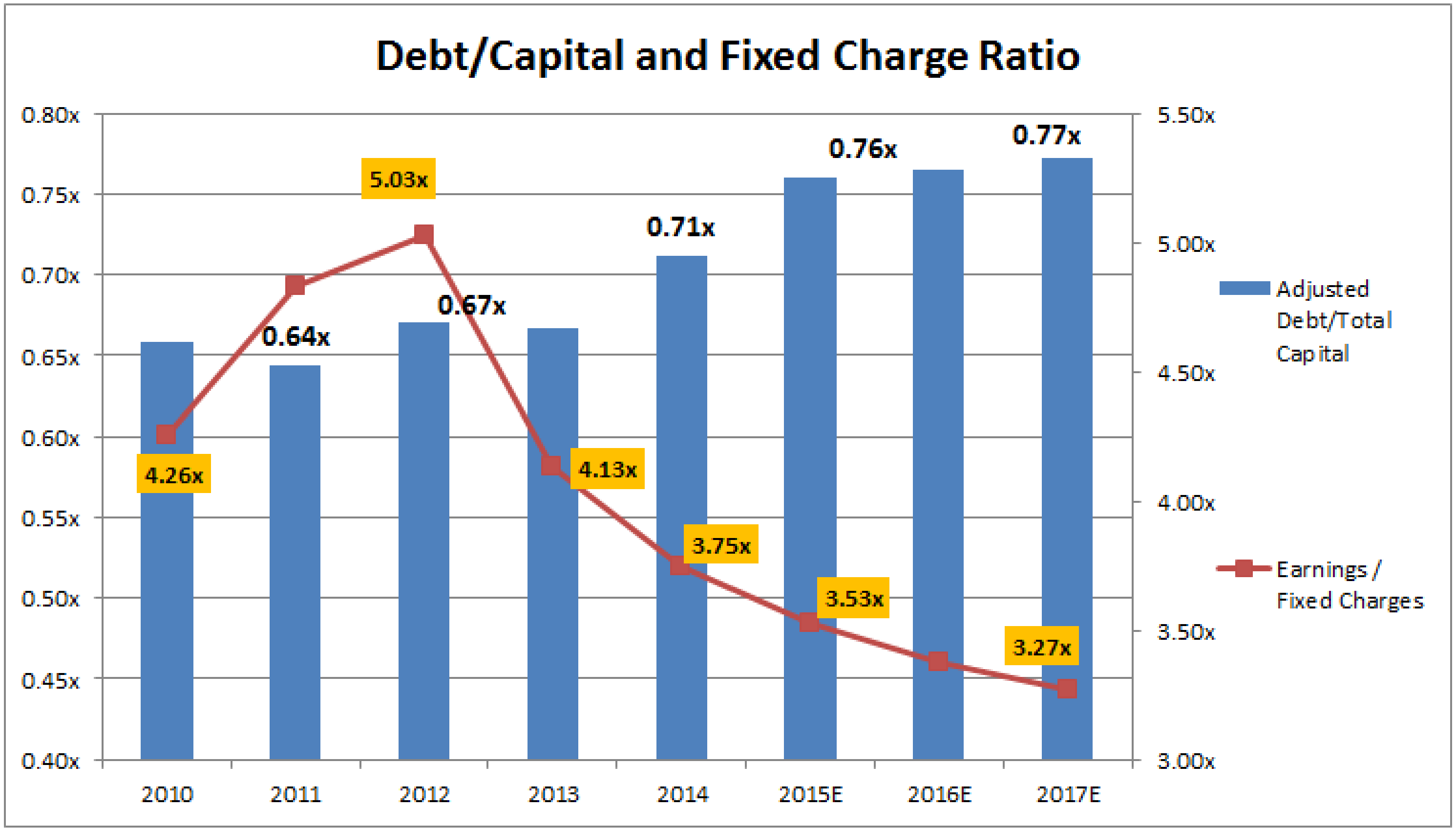
-Our base case suggests that comps remain flat, along with EBIT margins deleveraging by 120 bps to 8%. KSS continues to buy back 10m shares per year and FY17 EPS remains largely flat at $4.11, implying a -30% return at 10x FY17 EPS of $4.11.

-However, if comps turn negative faster than expected along with rapid margin degradation, EBIT margins compress by 210 bps to 7.1%, management is forced to slow its buyback as a result of decreasing FCF, and FY17 EPS comes in at $2.93 - implying -70% return at 6x FY17 EPS.

Appendix: Kohl's Square Footage Growth has been outpaced by Ross Stores and TJX



Appendix 2: Kohl's is likely to have liquidity issues in coming years



Liquidity Analysis	2010	2011	2012	2013	2014	2015E	2016E	2017E
EBITDA	**$2,547**	**$2,842**	**$2,936**	**$2,723**	**$2,631**	**$2,500**	**$2,424**	**$2,367**
Rent Expense	$270	$270	$270	$270	$270	$270	$270	$270
EBITDAR	**$2,817**	**$3,112**	**$3,206**	**$2,993**	**$2,901**	**$2,770**	**$2,694**	**$2,637**
Total Debt	$3,940	$3,998	$4,244	$4,553	$4,861	$4,861	$4,861	$4,861
Rent x 8	$2,160	$2,160	$2,160	$2,160	$2,160	$2,160	$2,160	$2,160
Total Indebtedness	**$6,100**	**$6,158**	**$6,404**	**$6,713**	**$7,021**	**$7,021**	**$7,021**	**$7,021**
Debt/EBITDAR	2.17x	1.98x	2.00x	2.24x	2.42x	2.54x	2.61x	2.66x
*look to maintain 2.25x - max permitted 3.75x								
Decline in EBITDAR needed to hit 3.75x						($900)	($824)	($767)
EBITDAR growth (historical / required)		10.5%	3.0%	-6.6%	-3.1%	**-35.5%**	**-32.5%**	**-30.6%**
EBITDAR margins (historical / required)	16.4%	16.9%	17.0%	15.5%	15.2%	**9.9%**	**9.9%**	**9.9%**
Total Capital (Debt + Equity - Cash)	$9,268	$9,571	$9,547	$10,064	$9,868	$9,558	$9,220	$9,148
Adjusted Debt/Total Capital	**0.66x**	**0.64x**	**0.67x**	**0.67x**	**0.71x**	**0.73x**	**0.76x**	**0.77x**
EBT	$1,548	$1,788	$1,859	$1,561	$1,404	$1,305	$1,230	$1,173
Fixed Charges	$500	$500	$500	$500	$500	$500	$500	$500
Total	**$2,048**	**$2,288**	**$2,359**	**$2,061**	**$1,904**	**$1,805**	**$1,730**	**$1,673**
Interest Expense	($311)	($304)	($299)	($329)	($338)	($342)	($342)	($342)
Interest on Rent	($170)	($170)	($170)	($170)	($170)	($170)	($170)	($170)
Total Fixed Charges	**($481)**	**($474)**	**($469)**	**($499)**	**($508)**	**($512)**	**($512)**	**($512)**
Earnings / Fixed Charges	**4.26x**	**4.83x**	**5.03x**	**4.13x**	**3.75x**	**3.53x**	**3.38x**	**3.27x**
Distributable Cash Flow (CFO - Capex)	$1,611	$949	$1,212	$480	$1,241	$1,057	$975	$913
Dividends Paid	$0	$0	($273)	($303)	($305)	($262)	($243)	($230)
Share repurchases (15m '15, 10m in '16-17)	($800)	($929)	($2,253)	($1,225)	($710)	($894)	($894)	($596)
Free cash After Distributions	$811	$20	($1,314)	($1,048)	$226	**($100)**	**($163)**	**$87**
Dividend Coverage Ratio	n/a	n/a	4.44x	1.58x	4.07x	4.03x	4.01x	3.96x
Shares Repurchased (millions)	n/a	n/a	35	34	17	15	15	10