KOHL'S

Key Takeaways

1	Core apparel and footwear sales continued to erode, leading to lower earnings.
2	FY24 outlook cut, implying mid to high single-digit negative holiday comps.
3	New CEO will be tasked with finding avenues to grow sales amid growing online off-price competition.

Kohl's turnaround remains elusive, as it reported another quarter of disappointing operating results leading management to once again cut its FY24 guidance.

3Q24 Performance Recap

3Q24 comps fell a worse-than-expected 9.3%, including a 3% drop in transactions. Management noted a weak back-to-school season and less private brand sales. However, not all categories were negative. As we have been covering, the Company has focused on increasing sales of underpenetrated categories like home, pet, gifting and impulse merchandise, and took steps to attract new and younger shoppers with the roll-out of Sephora shops and introducing Babies R Us shops in 200 locations for this holiday season. These categories saw growth in 3Q; Sephora shops pushed beauty sales up 15% in 3Q24 (beauty comps grew 9%). Together with Sephora, the growth categories have expanded to represent high-teens percent of total sales. However, adjusted for these categories, we estimate the erosion of core apparel and footwear comps slipped from negative high single-digits to over 10% in 3Q. Further, management admitted its strategy to focus on some of the above "underpenetrated" and brand name categories impaired other sales. Notably, private brand sales suffered, as inventory levels were displaced and dropped by 20%. The Company is now taking steps to increase its private brands, as it feels it is important to have these "opening price points in the current (macro) environment." Other displaced categories that management is focused on growing are fine jewelry (displaced with the introduction of Sephora shops) and petites.

Outlook

FY24 sales are now expected to fall 7% to 8%, with comps down 6% to 7%. The previous comp guidance range was a 3% decrease to a 5% decrease. The guidance implies a sequential improvement and management said November sales are off to a "marked improvement" relative to 3Q comps. However, the updated guidance still implies negative mid to high single-digit comps in the key holiday 4Q period. The sales compression will push operating margin down to a range of 3% to 3.2%, compared to prior guidance range of 3.4% to 3.8%.

CEO Transition

Yesterday, the Company announced a change at the top, as Ashley Buchanan of Michaels Cos. will replace Tom Kingsbury as CEO this January. Kingsbury has been CEO since in 2023, when he "signed up for two years" to help the Company during its "transition." Under his leadership, the Company has focused on cutting costs and conservatively managing inventory, which has helped gross margin (up 20 bps in 3Q24). However, sales and market share at the core apparel and footwear categories have continued to erode.

Buchanan was CEO at Michaels since 2020, and prior to that held various roles at Walmart, including chief merchandising of Sam's Club and COO for Walmart.com. Although he serves on the board of Macy's, a role he plans to vacate, he has limited experience managing an apparel or fashion company.

Buchanan will be tasked with bringing new ideas to fix the merchandising and store presentation, as the Company is losing market share, particularly from encroaching online competitors like Amazon and off-price operators like TJX and Ross.

One area that will likely need to be addressed is store closures. Despite the headwinds facing the sector and downsizing by other traditional department store chains, Kohl's store count of 1,178 has instead grown by a handful over the past five years. Management noted that over 90% of its stores are still "forward cash positive." However, given the ongoing sales erosion, that number is likely to grow, with the potential for 100s of future stores closures.

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