Company Note Overseas
2021. 12. 27

Shoe Carnival Inc. (SCVL.US)

N/R

Analyst Robert Cheek
02-3787-2261 r.cheek@hmsec.com

Ready to run

Consumer Discretionary: Specialty Retail

Shoe Carnival Inc. (SCVL.US)

Shoe Carnival (SCVL) is a fast-growing family footwear retailer that operates 377 stores across the US. 95% of its stores are located in power strip centers, co-locating with Burlington (BURL), Five Below (FIVE), Kohl's (KSS), Ross (ROST), Target (TGT), and several TJX companies (TJX), including TJ Maxx, HomeGoods, and Marshalls. Shoe Carnival primarily merchandises major athletic, casual, and dress shoes. The company keeps roughly 20% of its market cap in cash on its debt-free BS and trades at a deep discount to its peers and the broader S&P 500. With record-high quarterly results and strong FCF, the company is poised to deploy capital to repurchase shares, raise its dividend, and fund capex for store improvements. As the visibility for FY22 becomes clearer, we expect the shares to re-rate higher over the next year.

Shoe Carnival is our weekly top pick as it is1) a deeply discounted growth stock; 2) offers investors a stable dividend; 3) buying back shares and 4) is now entering an aggressive growth stage and has the means to execute on its plans.

Stock pick for the fourth week of December

Shoe Carnival, Inc. (SCVL)

About Shoe Carnival, Inc. (SCVL)

Shoe Carnival, Inc. was founded in 1978 and is headquartered in Evansville, Indiana. The company, together with its subsidiaries, operates as a family footwear retailer in the US. It sells various athletic, casual, and dress footwear and related products for men, women, and children, including backpacks, belts, handbags, hats, socks, shoe care items, sport bags, water bottles, and wallets. The company operates through its physical stores as well as online. As of Jan 30, 2021, the company operated 377 stores in 35 states and Puerto Rico, and also sells its products at shoecarnival.com, as well as through its mobile application.

Rationale

Shoe Carnival is a promising growth story because it provides an optimum mix of e-commerce and physical momentum. Shoppers enjoy the carnival-like experience of in-store shopping with up-tempo music, real-time promotions, and games. The company has transformed shoe shopping into an event, which along with its fast-growing online business, should continue to appeal to consumers of all types.

The record-breaking 3Q provides the company with the resources to fuel its aggressive growth plan.

The company has had an outstanding year. Consumer demand for footwear and especially popular athletic brands such as Nike (NKE) has created an entertaining shopping atmosphere at its 377 locations and online storefront. In late Nov 2021, the discount footwear retailer posted strong 3Q results in its earnings report and announced the acquisition of Shoe Station, a privately held retailer. We expect the deal to add to earnings in the coming fiscal year, along with fueling Shoe Carnival's aggressive expansion strategy. The record-breaking 3Q provides the company with the resources to fuel its aggressive growth plan. Store traffic jumped more than 40%, helping revenue to rocket 39.9% YoY to USD356.3mn. In addition, comps rose 30.1%.The company is now executing next phase of its expansion strategy and plans to grow from a USD1bn company into a multi-billion-dollar enterprise.

Shoe Carnival's leaders are long-tenured and excel at executing the company's growth strategy. Vice chairman Clifton Sifford has been with the company for almost 25 years. Chairman of the bard J. Wayne Weaver served in the role for more than three decades. Mr. Weaver's previous role was president and CEO of Nine West Group, where he built the footwear brand into one of the biggest players in the industry. CFO Kerry Jackson has led the company's finance and treasury for 25 years. In addition, the Sifford and Weaver families are invested in the company, with respective holdings of 1% and 35% of shares outstanding. As such, board's interests are aligned with those of shareholders. On Oct 1, Mark Worden was appointed CEO as part of Shoe Carnival's strategic succession plan. Worden joined the retailer three years ago following a 25-year career in brand management and most recently served as chief customer officer and president. The combination a CEO with only three years tenure provides Shoe Carnival with an ideal mix in which the company benefits from long-tenured leadership on the board and a CEO with a new perspective.

On Dec 3 Shoe Carnival announced its acquisition of the family-owned held shoe retail chain Shoe Station for USD67mn in cash. Shoe Station has 21 retail outlets in the southeastern US, along with a comprehensive e-commerce site, which should help Shoe Carnival expand its e-commerce presence more quickly, along with rapidly expanding its brick-and-mortar retail footprint. Profits should accrue from the buyout straightaway, with a USD100mn revenue increase anticipated in FY22 and gains to adjusted EPS in 2022. Even with the purchase, the company still has roughly USD100mn in cash on hand. The company's growth strategy is designed to obtain new customers, increase same-store sales (SSS), and boost store productivity and is building it on the following three pillars: 1) expand the digital business; 2) remodel stores and build clusters in existing states; 3) refine customer relationship management

Shoe Carnival is working with the buy now, pay later payment platform Klarna, which allows customers to buy interest-free with four installment payments

Shoe Carnival was relatively unfocused on its digital commerce endeavors, but the pandemic compelled it to accelerate its digital investments, including the allocation of 70% of its ad budget to digital media. The result of this newfound focus was that 19% of sales in FY20 were digital, and the company is targeting digital to account for minimum of 20% of total sales by FY23. We think the company's goal is conservative and see digital growing to 25% or more by FY23. Shoe Carnival is working with the buy now, pay later payment platform Klarna, which allows customers to buy interest-free with four installment payments. What is more, to bolster its digital business, the company bulked up its vendor direct-ship program, whereby some footwear is exclusive to its digital platforms and shipped directly to customers, mitigating inventory risk. Furthermore, to optimize efficiency, it can ship direct from its stores it rather than from the central distribution center. It also offers a buy online, pick-up in store service and program that it calls Shoes 2U, in which it ships orders to direct to customers if the item is unavailable when the customer visits a store.

In addition to the store remodels, stores with the highest potential will also have a Nike (NKE) shop-within-a-shop. As of today, there are more than 100 stores that have a Nike shop, and the company plans to double that amount through FY23. Despite its aggressive growth, Shoe Carnival will likely add new stores at a measured rate as it has benefitted from this approach.

Stable dividends

Shoe Carnival has been growing its earnings at a rapid pace, up 40% per year for five consecutive years.

Dividends are an important contributor to investment returns and are usually paid out of income, so if a company pays out more than it earned, its dividend runs the risk of being cut. At present, Shoe Carnival's DPS is just 5.9% of its after-tax profit, which is easy to maintain. Furthermore, Shoe Carnival generated enough FCF to easily cover its dividend, with the company paying out 6.6% of its cash flow in 2020. As Shoe Carnival's dividend is covered by profits and cash flow, it is sustainable, and the lower payout ratio provides a greater margin of safety. Companies with consistently growing EPS are typically the best dividend stocks, as it is usually easier for them to grow DPS. And Shoe Carnival has been growing its earnings at a rapid pace, up 40% per year for five consecutive years. Another way to gauge the dividend outlook is by measuring its historical rate of dividend growth. The company has posted 12% dividend growth per year on average for nine consecutive years. Dividends and per-share earnings have been growing rapidly in recent time, which is a very good sign. In addition, the company continues to reinvest the bulk of its profits back into its business.

Revamping existing stores to ramp up growth

In 3Q, its Shoe Perks loyalty program jumped more than 10% YoY, and now has more than 28.5mn members

Shoe Carnival is transforming from a traditional value shop with carpeted, flat imagery because it thinks the winners will be those who can motivate customers to visit stores for a fun shopping experience. And the company is investing to make it a reality. After seeing large numbers of new customers visit its revamped stores, the company expedited its remodeling plan. In 3Q, its Shoe Perks loyalty program jumped more than 10% YoY, and now has more than 28.5mn members, according to the company.

Shoe Carnival operates 377 stores in 35 states and Puerto Rico, and in Nov said it plans on more store openings entering 2022.

Around 100 stores will be refreshed by spring of 2022. In those stores, shiny new floors replace carpet. Comfortable seating areas, digital interactive engagements, and pop-ups with the brands and new products, will enhance the store environment. And the company is also increasing its customer service efforts to a degree that is uncommon in discount stores and increasingly at department stores. At Shoe Carnival, customers can opt for self-service shopping but can also get assistance for various needs such as measurements, etc. Most discount retailers do not have the staff to provide that level of customer service, which is a key differentiator for Shoe Carnival. Shoe Carnival operates 377 stores in 35 states and Puerto Rico, and in Nov said it plans on more store openings entering 2022. It plans to focus its store openings on existing geographies, but will expand to other areas, according to the company. In Dec, it acquired Shoe Station for USD67mn. Shoe Station runs 21 stores in the Southeastern US.

While new concerns about the resurging pandemic poses a threat to most brick-and-mortar retailers, Shoe Carnival has cultivated relationships with vendors as part of its efforts avoid the brunt of the supply chain woes hitting the industry.

Market outlook

Shoe Carnival's core customer demographic is a working-class family with children. The majority of its customers have an annual household income at the sub USD100,000 level, out of which roughly a third are below USD30,000. The majority of its customers are less than 55 years of age, with more than half between the ages of 36 and 55. Its customers demand brand name footwear for discounted prices and enjoy the one-stop shopping specialty store format for the entire family. As such, there are few, if any, direct competitors. For this particular demographic, big-box discount retailers is the only alternative and finding brand names is a difficult endeavor due to the limited quantities available at such locations. The big box competitors include Burlington, Marshalls, TJ Maxx, and Ross. Since Shoe Carnival customers desire brand names, they are unlikely to shop for footwear at Walmart (WMT) or Target (TGT), while Kohl's (KSS) is too pricey.

Shoe Carnival is consistently successful because of its long-term planning and ability to capitalize on opportunities. The company uses tactics such as expanding inventory prior to back-to-school sales, and forging strong vendor partnerships, which allow its stores to avoid many the supply chain problems beleaguering many other businesses.

3Q earnings results

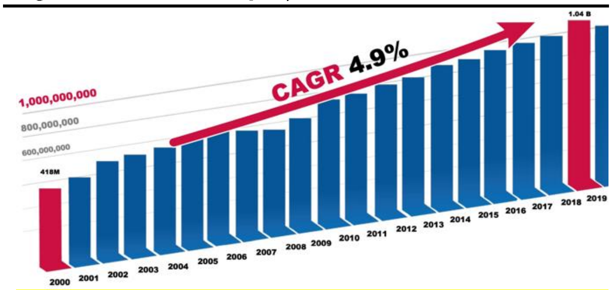
3Q21 was the best quarter and best year in the company's history, with the highest quarterly earnings ever

On Nov 17 Shoe Carnival announced record quarterly net income of USD46.8mn and record diluted net income per share of USD1.64. Quarterly net sales were a record high at USD356.3mn and quarterly comparable store sales increase of 30.1%. Quarterly gross profit of USD144.1mn was a record high and quarterly gross profit margin of 40.4%. The omnichannel growth model continues to gain traction as e-commerce comparable sales jumped 12.5% YoY. The Shoe Perks customer loyalty program membership advanced by more than 10% YoY with total membership exceeding 28.5mn. Cash, cash equivalents, and investments totaled USD191.2mn with no outstanding debt as of Oct 30, 2021. It was the best quarter and best year in the company's history, with the highest quarterly earnings ever. Net income per share and operating income were both 3x higher than the results of any 3Q. Store traffic was up more than 40% and all comparable stores generated positive cash flow YTD. SG&A expenses for 3Q FY 21 rose USD14.0mn to USD81.6mn. Roughly half of the rise was due to higher advertising expense, with the remaining increase attributable to wages, including incentive compensation. Net sales for the first nine months of FY21 exceeded USD1bn at USD1,017mn, compared to USD722.9mn in the first nine months of FY20. SSS surged 41.6% for the first nine months of FY21.

As of Oct 30, 2021, it had USD42.9mn available for future repurchases under its share repurchase program.

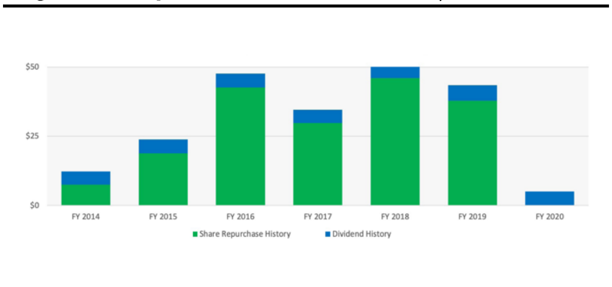
Gross profit margin for the first nine months of FY21 reached 40.3% compared to 27.9% in the same period last year. SG&A expenses for the first nine months increased USD39.7mn to USD230.2mn. As a percentage of net sales, expenses fell to 22.6% compared to 26.3% in the first nine months of FY20. For the first nine months of FY21 net income was USD134.3mn, or USD4.69 per diluted share, compared to net income of USD8.5mn, or USD0.30 per diluted share, for the first nine months of FY20. Based on the continued strength in the underlying business, management raised its outlook for full-year fiscal 2021 and expects diluted net income per share of USD5.00 to USD5.10 and net sales of USD1.285bn to USD1.290bn. In 3Q, the company repurchased 91,594 shares of common stock at a total cost of USD3.2mn. In the first nine months of FY21, the company has repurchased 208,662 shares of common stock at a total cost of USD7.1mn. As of Oct 30, 2021, it had USD42.9mn available for future repurchases under its share repurchase program.

Fig 1. Billion-dollar company



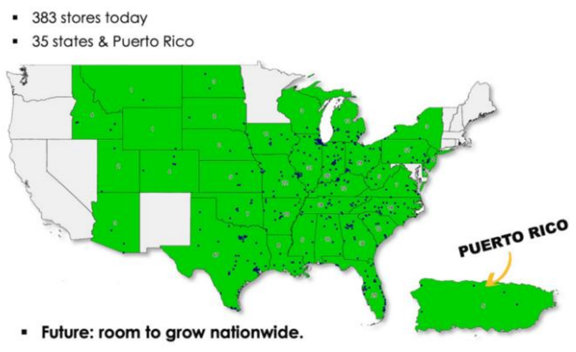
Source: Shoe Carnival, Hyundai Motor Securities

Fig 2. Share repurchase and dividend history



Source: Shoe Carnival, Hyundai Motor Securities

Fig 3. Regional leader with room to grow I



Source: Shoe Carnival, Hyundai Motor Securities

Fig 4. Regional leader with room to grow II

Source: Shoe Carnival, Hyundai Motor Securities

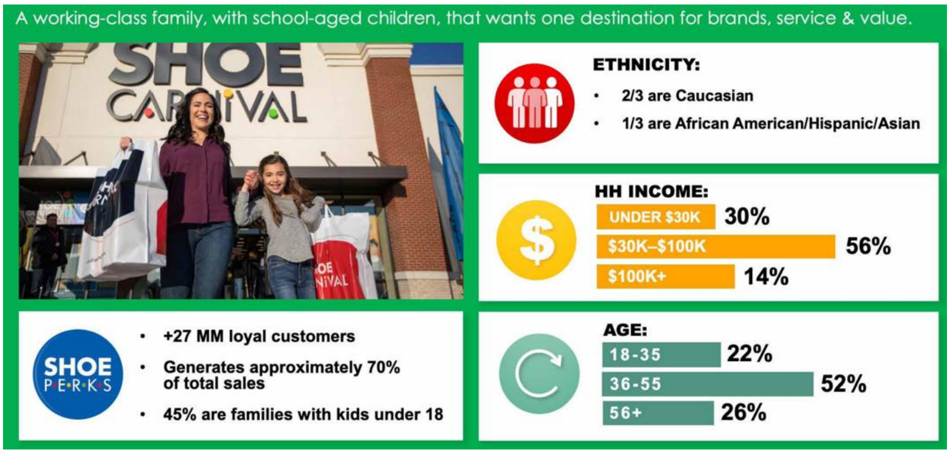
Fig 5. ~95%of Shoe Carnival stores located in power strip centers

Source: Shoe Carnival, Hyundai Motor Securities

Fig 6. Commitment to brand stories

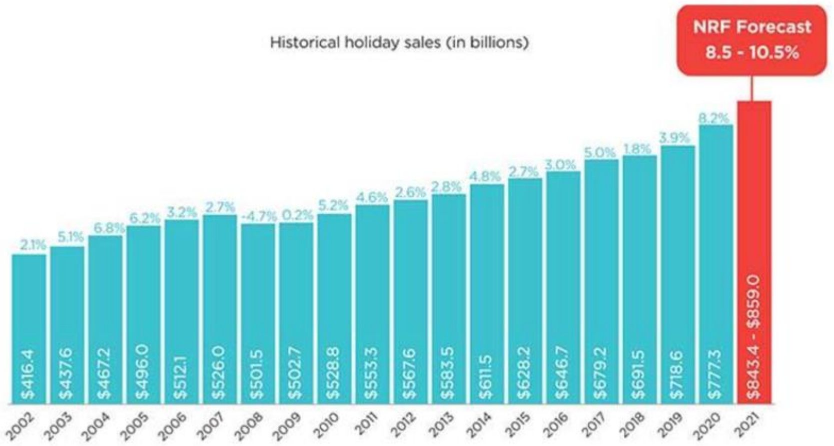
Source: Shoe Carnival, Hyundai Motor Securities

Fig 7. Shoe Carnival customer demographics



Source: Shoe Carnival, Hyundai Motor Securities

Fig 8. National Retail Federation says 2021 holiday spending could grow by a record 8.5% to 10.5% over 2020



Source: NRF, Hyundai Motor Securities

Fig 9. Key investment points

Source: Shoe Carnival, Hyundai Motor Securities

Valuation and risks

The company's P/E of 7.97x implies a considerable discount compared to specialty retailers and a deep discount to the S&P 500 average of 29.77x.

Shoe Carnival's market cap as of Dec 23 is USD23.2bn. The company's P/E of 7.97x implies a considerable discount compared to specialty retailers and a deep discount to the S&P 500's 29.77x. Furthermore, its P/B of 2.54x is a considerable discount vs. the S&P 500's 4.87x and a significant discount vs. other companies in its sector. According to these and other key valuation criteria, we find the stock very attractive as it offers both growth and a deep discount relative to peers and the broader index.

While Shoe Carnival's future looks bright, there is one potential risk which we have identified. The company's initiatives are working, but the one big risk is that its current acquisition and planned further acquisitions could draw the ire of the Federal Trade Commission (FTC). On Dec 3, the FTC announced that it will no longer maintain the hands-off merger policy it has followed since 1995. If Shoe Carnival uses its cash to engage in an acquisition binge as part of its expansion strategy, it could draw the FTC's notice and possibly even lawsuits from the agency. Nevertheless, even with this risk, the stock is best-in-class among shoe stocks and utilizing its 2021 windfall profits to for long-term growth.

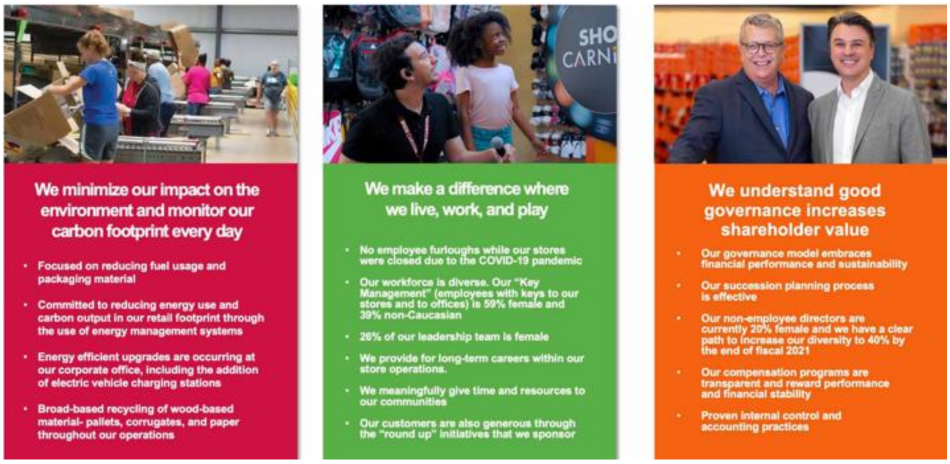
The bottom line

We think Shoe Carnival will easily outrun its competitors on multiple fronts. It is an attractive stock and offers investors a winning combination of growth, stable dividends, and a deeply discounted valuation. The company has been growing earnings at a rapid rate, and has a low payout ratio, indicating that it is reinvesting heavily in its business, which is a winning combination. The company marks all of our checkpoints for a winning stock and as such is our top pick for the week.

Fig 10. Family house of brands (avg. over 25k pairs of shoes per store)

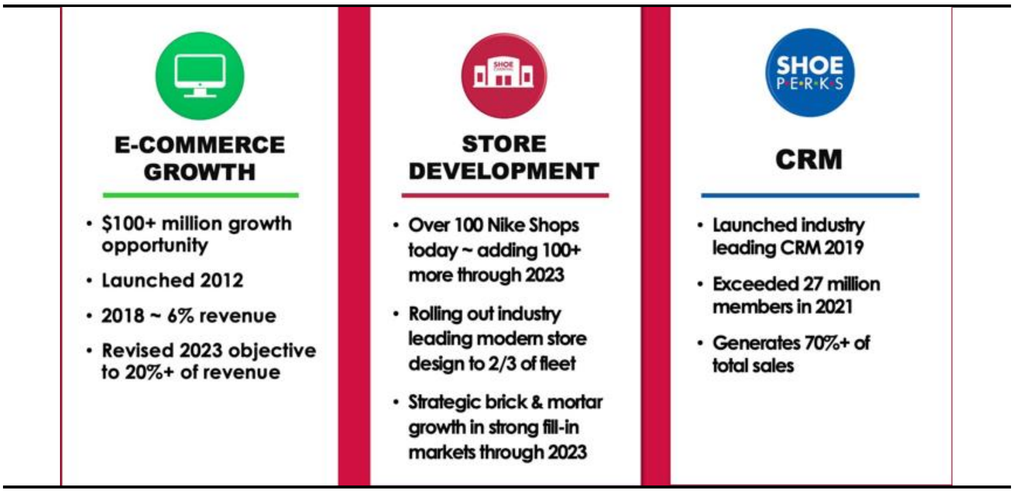
Source: Shoe Carnival, Hyundai Motor Securities

Fig 11. ESG commitment



Source: Shoe Carnival, Hyundai Motor Securities

Fig 12. Strategic growth priorities (2021-23)



Source: Shoe Carnival, Hyundai Motor Securities

Fig13. Key business drivers I

Source: Shoe Carnival, Hyundai Motor Securities

Fig 14. Key business drivers II

Source: Shoe Carnival, Hyundai Motor Securities

Fig 15. Key business drivers III

Source: Shoe Carnival, Hyundai Motor Securities

Fig 16. Key business drivers IV

Source: Shoe Carnival, Hyundai Motor Securities

Fig 17. Show Carnival image, past and present

Source: Shoe Carnival, Hyundai Motor Securities

Fig 18. Shoe Carnival acquires rival Shoe Station

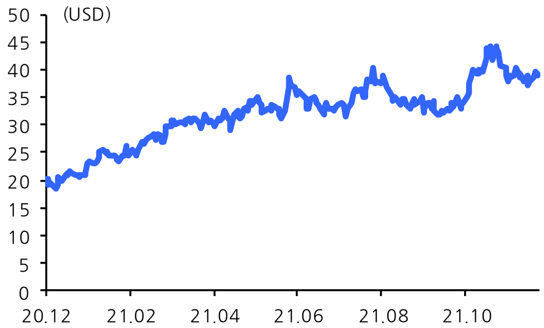
Source: Shoe Carnival, Hyundai Motor Securities

Fig 19. Peer Valuation

Company	Ticker	Market Cap(USDmn)	P/E Ratio	P/S Ratio	EV/EBITDA	Sales Growth (%)
Shoe Carnival, Inc.	SCVL	1,106	7.94	0.88	5.46	NA
Five Below, Inc.	FIVE	10,844	41.52	4.19	27.75	NA
Ross Stores, Inc.	ROST	38,923	24.67	2.22	15.49	NA
Target Corporation	TGT	105,891	13.59	1.15	10.63	NA
The TJX Companies, Inc.	TJX	87,975	34.03	2.01	20.38	NA

Source: Thomson One, Hyundai Motor Securities

Fig 20. SCVL Stock Price



Source: Bloomberg, Hyundai Motor Securities

Compliance note

- The author(s) of this report does (do) not have any interests in the company (ies) covered herein.
- Hyundai Motor Securities has not disclosed the material contained in this report to any institutional investor or third party prior to its publication.
- The author(s) of this report does (do) not own more than 1% of the shares of the company (ies) covered in this report.
- The company covered herein is an affiliate of Hyundai Motor Securities
- This report accurately reflects the author Robert Cheek's professional views and was written without any undue external influence or interference.