Based in Menomonee Falls, Wisconsin, Kohl's Corp. will operate 1,089 department stores by the end of September 2010. The company's stores cater to middle-income customers shopping for their families and their homes. About one-third of the $17 billion of FY10 sales came from women's clothing, while menswear and products for the home contributed almost 20% each. About 47% of sales are from private brands and national brands that are tailored specifically for Kohl's, this is up from 25% in FY04. These include Simply Vera from Vera Wang, Dana Buchman, and Tony Hawk. The company operates about 79 million square feet of selling space.

Analyst's Notes

Analysis by Christopher Graja, CFA, August 12, 2010

ARGUS RATING: BUY

- KSS: Second-quarter earnings beat our estimate
- We are maintaining our BUY rating on Kohl's with a target price of $65.
- Kohl's reported second-quarter EPS of $0.84, which topped our upwardly revised estimate of $0.80 on lower expenses than we expected. The actual result was $0.09 better than the top of the guidance range that the company provided at the beginning of the quarter.
- On the surface, the company's new full-year EPS guidance range of $3.57-$3.70 looks a little soft, but it doesn't affect our long-term view of the stock. The revised guidance reflects three expense-related issues discussed below.
- The shares are trading at an enterprise value of about 7.2-times trailing EBIT. It is important to remember that KSS has $2.5 billion in cash and $298 million in long-term investments. We believe that high-quality retailers are attractive at less than 12-times trailing EBIT.

INVESTMENT THESIS

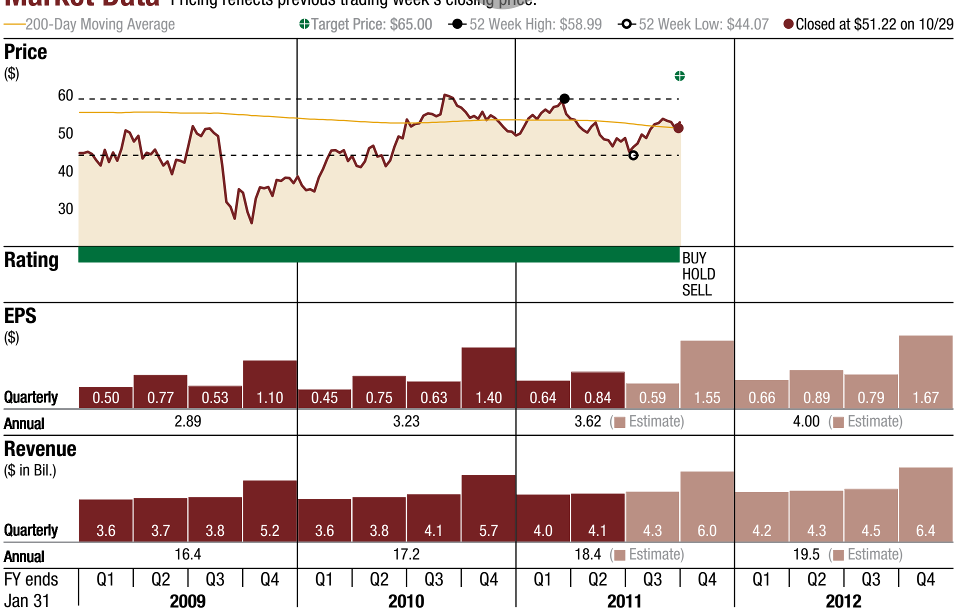
We are maintaining our BUY rating on Kohl's Corp. (NYSE: KSS) with a target price of $65.

In our opinion, the company has the ability to boost sales by opening new stores and improving merchandise; the ability to make small improvements to industry-leading margins through inventory management and the sale of private-label merchandise; and the ability to deploy cash to open new stores, remodel existing ones and repurchase shares.

Kohl's faces strong competition from J.C. Penney, Target and an aspiring fashion merchant called Wal-Mart. For now, however, Kohl's seems to be making the right merchandising decisions in adding products from the likes of the Food Network, skateboarder Tony Hawk, designer Vera Wang, and TV starlet Lauren Conrad. The company must also compete with Macy's and Gap (which we believe will be trying hard to increase same-store sales at its Old Navy stores).

Market Data

Pricing reflects previous trading week's closing price.



Argus Recommendations

Twelve Month Rating	SELL	HOLD	**BUY**
Five Year Rating	SELL	HOLD	**BUY**
Sector Rating	Under Weight	Market Weight	**Over Weight**

Argus assigns a 12-month BUY, HOLD, or SELL rating to each stock under coverage.

- BUY-rated stocks are expected to outperform the market (the benchmark S&P 500 Index) on a risk-adjusted basis over the next year.
- HOLD-rated stocks are expected to perform in line with the market.
- SELL-rated stocks are expected to underperform the market on a risk-adjusted basis.

The distribution of ratings across Argus' entire company universe is: 53% Buy, 42% Hold, 5% Sell.

Key Statistics

Key Statistics pricing data reflects previous trading day's closing price. Other applicable data are trailing 12-months unless otherwise specified

Market Overview

Price	$51.92
Target Price	$65.00
52 Week Price Range	$44.07 to $58.99
Shares Outstanding	307.99 Million
Dividend	--

Sector Overview

Sector	Consumer Discretionary
Sector Rating	OVER WEIGHT
Total % of S&P 500 Market Cap.	10.00%

Financial Strength

Financial Strength Rating	MEDIUM
Debt/Capital Ratio	20.8%
Return on Equity	13.3%
Net Margin	6.1%
Payout Ratio	--
Current Ratio	2.29
Revenue	$17.87 Billion
After-Tax Income	$1.08 Billion

Valuation

Current FY P/E	14.34
Prior FY P/E	16.07
Price/Sales	0.89
Price/Book	1.91
Book Value/Share	$27.20
Market Capitalization	$15.99 Billion

Forecasted Growth

1 Year EPS Growth Forecast
12.07%

5 Year EPS Growth Forecast
15.00%

1 Year Dividend Growth Forecast
N/A

Risk

Beta	1.03
Institutional Ownership	86.95%

Please see important information about this report on page 8

Analyst's Notes...Continued

We advise potential buyers to prepare for additional volatility and the possibility that the retail environment could be more difficult than we currently expect.

Gauging the downside can be very difficult in a volatile market. We would consider lowering our rating if the company seemed to be losing market share, but for now, KSS is one of our favorite retailers. And management seems to be doing an excellent job executing its business plan. The company posted a very impressive increase in comparable sales for the year ended January 30, 2010, with a 4.5% increase in the fourth quarter. It also posted a 7.4% increase in the first quarter and a 4.6% increase in the second quarter. Our long-term rating for Kohl's remains BUY.

RECENT DEVELOPMENTS

Kohl's reported second-quarter EPS of $0.84, which topped our upwardly revised estimate of $0.80 on lower expenses than we expected. The actual result was $0.09 better than the top of the guidance range that the company provided at the beginning of the quarter.

Net income increased 14% as sales rose 7.7% to $4.1 billion, which was in line with our estimate. Same-store sales rose 4.6%, which is impressive in this environment. The company is seeing strong growth in the number of transactions, partly offset by fewer units per transaction and a lower price per unit. We expect this trend to continue. We believe that there was growth across geographic regions and in most product lines. E-commerce revenue increased 50% and the company is investing to build this part of the business.

The company's gross margin rose 30 basis points to 40.3% in the quarter, which was slightly below our estimate. We think the company has been doing a very good job managing its inventory. Shoppers are also responding to its private and exclusive brands. These products generally provide higher margins than national brands. The company's three largest private brands, Croft & Barrow, Sonoma and Apt.9, all performed much better than the company average and as did Jumping Beans and Vera Wang.

Selling, general and administrative expenses were 25.5% of sales in the quarter, up from 25.4% in the prior-year period. The result was about 70 basis points lower (better) than our forecast. In dollars, SG&A was about $27 million lower than we expected. We believe that about a third of the variation, relative to our estimate, reflected costs that we expected in the second quarter that are likely to be shifted to the third quarter.

Depreciation was $2 million below our estimate, and preopening expense was $2 million below our expectation.

The company's operating margin was 10.9% in the quarter, up from 10.5% a year earlier and 40 basis points above our estimate. The company's interest expense matched our estimate, and the tax rate of 38.7% was also about what we expected.

The company's inventory-per-store was up 3%, which is encouraging. Cash flow from operations came to $628 million in the first half, down from $1 billion in the year-ago period. Net

Growth & Valuation Analysis

GROWTH ANALYSIS ($ in Millions, except per share data)	2006	2007	2008	2009	2010
Revenue	13,444	15,597	16,474	16,389	17,178
COGS	8,664	9,922	10,460	10,334	10,680
Gross Profit	4,780	5,675	6,014	6,055	6,498
SG&A	3,025	3,472	3,758	3,978	4,196
R&D	—	—	—	—	—
Operating Income	1,416	1,815	1,804	1,536	1,712
Interest Expense	70	40	62	111	124
Pretax Income	1,346	1,774	1,742	1,425	1,588
Income Taxes	504	666	658	540	597
Tax Rate (%)	37	38	38	38	38
Net Income	842	1,109	1,084	885	991
Diluted Shares Outstanding	346	335	320	307	306
EPS	2.43	3.31	3.39	2.89	3.23
Dividend	—	—	—	—	—
GROWTH RATES (%)					
Revenue	14.9	16.0	5.6	-0.5	4.8
Operating Income	18.7	28.1	-0.6	-14.9	11.5
Net Income	19.7	31.7	-2.2	-18.4	12.0
EPS	19.1	36.2	2.4	-14.7	11.8
Dividend	—	—	—	—	—
Sustainable Growth Rate	—	—	—	—	—
VALUATION ANALYSIS					
Price: High	$75.54	$79.55	$56.00	$60.89	—
Price: Low	$42.78	$44.16	$24.28	$32.50	—
Price/Sales: High-Low	1.9 - 1.1	1.7 - 0.9	1.1 - 0.5	1.1 - 0.6	— - —
P/E: High-Low	31.1 - 17.6	24.0 - 13.3	16.5 - 7.2	21.1 - 11.2	— - —
Price/Cash Flow: High-Low	8.5 - 4.8	23.7 - 13.2	10.2 - 4.4	8.4 - 4.5	— - —

Financial & Risk Analysis

FINANCIAL STRENGTH	2008	2009	2010
Cash ($ in Millions)	181	643	2,267
Working Capital ($ in Millions)	1,953	1,884	3,095
Current Ratio	2.10	2.02	2.29
LT Debt/Equity Ratio (%)	33.6	30.5	26.1
Total Debt/Equity Ratio (%)	33.8	—	—
RATIOS (%)			
Gross Profit Margin	36.5	36.9	37.8
Operating Margin	11.0	9.4	10.0
Net Margin	6.6	5.4	5.8
Return On Assets	11.1	8.1	8.1
Return On Equity	18.5	13.8	13.6
RISK ANALYSIS			
Cash Cycle (days)	—	—	—
Cash Flow/Cap Ex	0.8	—	—
Oper. Income/Int. Exp. (ratio)	—	11.8	12.9
Payout Ratio	—	—	—

Please see important information about this report on page 8

Analyst's Notes...Continued

income increased, but inventory, payables, accrued liabilities and taxes all represented drags compared with the prior year period. Free cash flow was $207 million.

We should note that the company's report is on a GAAP basis, and does not exclude any 'charges, write-downs, integration costs or one-time items.' Overall, it was a very good quarter, especially given the current economic environment.

On the surface, the company's new full-year EPS guidance range of $3.57-$3.70 looks a little soft, but it doesn't affect our long-term view on the stock.

To understand all of the moving parts, we need to go back to the guidance of $3.57-$3.75 that the company provided at the end of the first quarter. When the company reported same-store sales last week, management raised its 2Q guidance to as much as $0.82 from a previous range of $0.70-$0.75. However, it did not update its full-year guidance last week. The company's actual 2Q earnings of $0.84 exceeded the top of management's original quarterly guidance by $0.09 ($0.84 minus $0.75).

Based on the reported EPS, it might have been reasonable to expect management to raise the top of the full-year guidance range by $0.09, to $3.84 - even if it didn't change its expectations for the second half of the year. Why is the top of guidance now just $3.70?

There are really three expense-related issues that account for the $0.14 gap between the $3.84 we might have expected and the top of the new guidance range of $3.70. The first, as mentioned above, is about $0.02 related to expenses that are likely to be incurred in the third quarter rather than in 2Q, when we expected them. The other $0.12 is related to the company's decision to add $20 million in advertising in the second half of the year, and to additional SG&A expense that will be required to comply with new Credit Act rules. We think KSS is making a good decision to invest in advertising in an attempt to gain more share. In the interest of being conservative, the revised guidance does not assume additional sales from the increased advertising.

Kohl's and Capital One have announced a new agreement for Kohl's private Label Credit Card Program.

EARNINGS & GROWTH ANALYSIS

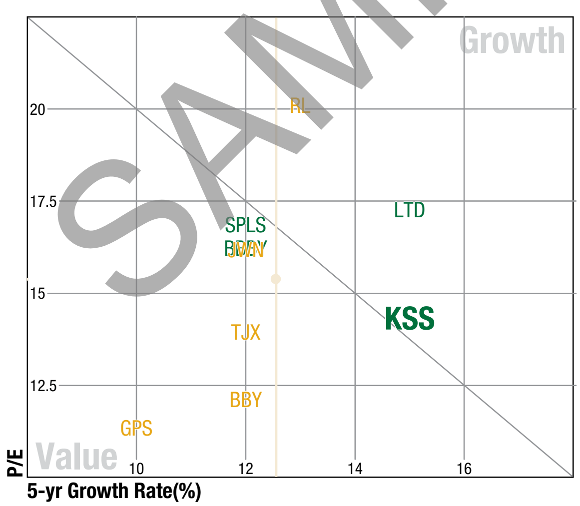
We are reducing our FY11 earnings estimate to $3.62 per share from $3.72. The change is largely due to the additional expenses discussed above.

We are maintaining our FY12 EPS estimate of $4.00, and our five-year annual earnings growth rate forecast of 15%. The company's five-year plan has been to have about 1,400 stores in 2012. We still expect the company to reach 1,400, but it may take a little longer than management initially expected. The company ended 2Q with 1,089 stores. We expect the company to open about 30 stores in FY11 (representing an incremental 80 million square feet of selling space) and remodel about 85 stores. Management seems pleased with the productivity of the remodeled stores, and we believe that the company is learning how to complete the remodels more quickly and with less disruption.

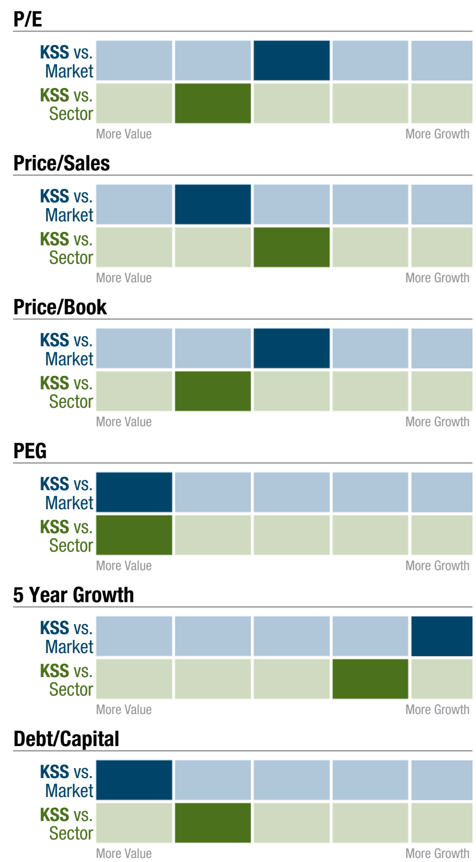
Peer & Industry Analysis

The graphics in this section are designed to allow investors to compare KSS versus its industry peers, the broader sector, and the market as a whole, as defined by the Argus Universe of Coverage.

- **The scatterplot shows how KSS stacks up versus its peers on two key characteristics: long-term growth and value. In general, companies in the lower left-hand corner are more value-oriented, while those in the upper right-hand corner are more growth-oriented.**
- **The table builds on the scatterplot by displaying more financial information.**
- **The bar charts on the right take the analysis two steps further, by broadening the comparison groups into the sector level and the market as a whole. This tool is designed to help investors understand how KSS might fit into or modify a diversified portfolio.**



Ticker	Company	Market Cap ($ in Millions)	5-yr Growth Rate (%)	Current FY P/E	Net Margin (%)	1-yr EPS Growth (%)	Argus Rating
TJX	TJX Companies Inc	18,779	12.0	13.9	6.5	6.5	HOLD
BBY	Best BUY Co Inc	17,378	12.0	12.1	2.8	4.2	HOLD
KSS	**Kohl's Corp**	**15,991**	**15.0**	**14.3**	**6.1**	**10.5**	**BUY**
SPLS	Staples Inc	15,143	12.0	16.9	3.4	23.6	BUY
GPS	Gap Inc	12,644	10.0	11.4	8.3	6.7	HOLD
BBBY	Bed Bath & Beyond Inc	11,611	12.0	16.2	8.4	8.7	BUY
LTD	Limited Brands Inc	10,145	15.0	17.3	7.3	9.9	BUY
JWN	Nordstrom Inc	9,190	12.0	16.2	5.6	8.9	HOLD
RL	Polo Ralph Lauren Corp	6,460	13.0	20.1	10.2	15.4	HOLD
Peer Average		**13,038**	**12.6**	**15.4**	**6.5**	**10.5**	



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Analyst's Notes...Continued

We think the company can generate normalized same-store sales growth of about 3%-5%, repurchase shares, and boost operating margins slightly. There may be a few bounce-back quarters where sales grow at a faster rate. Our main focus is financial strength and sustainable profit growth. We don't think there has been a major change in the company's competitive position (if anything, it may have improved), so it wouldn't concern us if the company was a little slower in opening stores.

We remain fairly optimistic about the things management can control - such as inventory and costs - but same-store sales will obviously be the big swing factor. There is a lot of competition out there, and our recent store visits suggest that J.C. Penney's merchandise looks pretty good. We think Wal-Mart's selection of clothing is improving, but the giant hasn't had success with the fashionable designer merchandise that is helping Kohl's and JCP.

FINANCIAL STRENGTH

Our financial strength rating for Kohl's is Medium, the midpoint on our five-point scale. The total debt was about 20% of capital at the end of the second quarter. The company owns the real estate at about 36% of its stores, owns 25% of its stores on leased ground, and leases 39% of stores. At the end of fiscal 2010, the company had 717 stores in strip centers, 66 in malls and 221 in free-standing locations. This level of ownership doesn't rank in the top tier of retailers we follow, but we believe that it represents a significant asset. The company's balance sheet lists the net value of property and equipment at about $7.3 billion. We believe that about two-thirds of this value is in land and buildings. It is also encouraging that the vast majority of the company's book value is tangible.

We estimate the present value of operating leases at $6.8 billion. Treating these fixed obligations as debt would raise the company's debt to about 51% of capital, which is about average for the retailers we follow. EBIT covered net interest expense by a factor of about 14 in both FY09 and FY10, down from 29 in FY08 and 40 in FY07, but still extremely solid. Kohl's had about $2.5 billion in cash at the end of the quarter and another $319 million of long-term investments. The company's operating margin has generally been higher than those of other department stores, including Macy's and J.C. Penney, and near the top of the range for our coverage universe. We believe that Kohl's has a remaining authorization to repurchase about $1.87 billion of its stock. We expect the company to consider repurchasing shares with its growing cash balance.

Fitch and S&P both rate the company's debt BBB+ and Moody's rating is Baa1. The outlooks are all stable. With debt at about 2.2-times adjusted EBITDAR at the end of FY10, we think management will try to maintain or slightly improve these ratings over the next few years.

With all of the recent credit turmoil, we're encouraged that the company has a $900 million line of credit through October 2011. The company had no borrowings on the credit line at the end of the first quarter. We'll update this information after we review the second-quarter report. The company has said that it expects to use funds from operations to repay about $400 million of debt that is due in 2011.

The company had $2.8 billion of cash and long-term investments at the end of the quarter. Management has been maintaining the large cash position pending completion of its new credit card agreement. The company has said that it will consider a buyback or initiating a dividend - or both, as a use for some of its additional cash.

MANAGEMENT & RISKS

In August 2008, Kevin Mansell replaced Lawrence Montgomery as CEO. He has also served as president (a title he retains) since 1999. He became chairman in September 2009. He joined the company as a divisional merchandise manager in 1982, and has worked in the retail industry for about 35 years. Wesley McDonald has been chief financial officer since July 2003. Prior to joining the company, he was chief financial officer at Abercrombie & Fitch from 2000-2003, and held various executive positions during his 12 years at Target Corp. He has more than 20 years of experience in the retail industry. Mr. McDonald is unique among CFOs of large retailers in that he handles most of the investor relations activity. We think his willingness to play that role is a positive for both the company and its shareholders.

In our view, the greatest risk for Kohl's is maintaining its niche in quality merchandise to value-conscious shoppers. The middle market, for apparel in particular, is a highly competitive business. The company must strike the right balance between exclusive brands and national brands and make sure that it doesn't abandon its core shopper as it attempts to add new and stylish merchandise. To date, it seems that the company has done a good job of giving core shoppers the merchandise they need with just enough sizzle to win additional business. In a tough economy, gaining additional sales can be the result of offering shoppers something that makes them feel happy and attractive while still coordinating with their existing wardrobe.

Kohl's faces pressure from full-line department stores and specialty retailers on the high end, J.C. Penney in the middle, and the discounters (Wal-Mart and Target) on the low end. We also believe that off-price retailers, such as T.J. Maxx, are a source of competition. With almost 20% of Kohl's sales coming from products for the home, the company also faces competition from Bed Bath & Beyond and Pottery Barn, as well as Target and JCP. We expect heightened competition in the market for home goods, as the housing market remains under pressure. The flip side is that this category could benefit from pent-up demand when the housing sector improves.

Management also faces execution risk with its aggressive building program, combined with the launch of the new product lines and the need to make the right fashion choices. To be sure, Kohl's has successfully defended its niche and expanded its base in the past.

Another risk is one that every retailer faces: the health of the overall economy and the strength of discretionary consumer spending. In 2006, the company sold its private-label credit accounts to JPMorgan Chase for about $1.6 billion. This probably slightly reduced the company's overall risk. At the time of the 2Q conference call, the company announced a new agreement with Capital One.

We believe that less affluent customers have, at times, seen their budgets squeezed by higher energy prices, by restricted access to credit, and higher food prices. The business is also somewhat seasonal; about 15% of sales come during the back-to-school season and 30% during the Christmas holiday season.

COMPANY DESCRIPTION

Based in Menomonee Falls, Wisconsin, Kohl's Corp. will

Analyst's Notes...Continued

operate 1,089 department stores by the end of September 2010. The company's stores cater to middle-income customers shopping for their families and their homes. About one-third of the $17 billion of FY10 sales came from women's clothing, while menswear and products for the home contributed almost 20% each. About 47% of sales are from private brands and national brands that are tailored specifically for Kohl's, this is up from 25% in FY04. These include Simply Vera from Vera Wang, Dana Buchman, and Tony Hawk. The company operates about 79 million square feet of selling space.

Like other department stores, Kohl's uses a nine-box grid to plan its merchandise assortments. About 40% of merchandise is in the 'Classic' column, 40% is 'Modern Classic,' and 12% is 'Contemporary.' Some 45% of merchandise, like Lee jeans, falls in the 'Good' row; 40%, including Levi's, Jockey and Adidas are in the 'Better' row, and 15% of merchandise, including Chaps and Nike offerings, falls in the 'Best' row. Croft & Barrow, Sonoma and Apt.9 are the three largest private brands.

VALUATION

Kohl's shares are down about 12% in the last year. The shares trade at about 12.7-times our FY11 estimate and 12.3-times our FY12 forecast. We believe that the shares are attractively valued at a discount to the market multiple of about 14-times our 2010 earnings estimate. In our opinion, there is upside to our earnings estimate as the economy stabilizes. Trading at 13-times trailing earnings, the shares are still below their five-year average of 17.8.

Using a multistage dividend discount model, we estimate a fair value for KSS above $65.

Based on our assumptions that EPS will increase 15% annually for the next five years and that the shares will trade at a terminal P/E of 14, a simple discounted earnings model puts the value of the shares at about $65.

The shares are trading at an enterprise value of about 7.2-times trailing EBIT. It is important to remember that KSS has $2.5 billion in cash and $298 million in long term investments. We believe that high-quality retailers are attractive at less than 12-times trailing EBIT. The company's five-year average is 11. At 10-times our EBIT forecast for FY11, the shares would be worth about $65.

We are maintaining our target price of $65.

We advise potential buyers to prepare for volatility and the possibility that the macroeconomic environment could be more difficult than we currently expect.

On August 12 at midday, BUY-rated KSS traded at $46.48, down $1.30.

Analysis by Christopher Graja, CFA, August 6, 2010

ARGUS RATING: BUY

- KSS: Reiterating BUY and raising FY11 EPS estimate
- We are raising our FY11 earnings estimate to $3.72 per share from $3.65. Kohl's second-quarter sales rose 7.7% to $4.1 billion based on its July sales report. That was better than the 7% increase we expected.
- For July, total sales increased 7.1% while comparable sales rose 4.1%, which was inline with consensus. The company said that it had a high single-digit improvement in the number of transactions offset by declines in average selling price and units per transaction.
- We're raising our estimate for the second quarter to $0.80 from $0.74 per share. The increase assumes better sales than we initially expected, some additional expense leverage, and a slightly higher gross margin estimate. The company will report 2Q earnings on August 12.
- Using a multistage dividend discount model, we estimate a fair value for KSS above $65. Based on our assumptions that EPS will increase 15% annually for the next five years and that the shares will trade at a terminal P/E of 15, a simple discounted earnings model puts the value of the shares at about $65.

INVESTMENT THESIS

We are maintaining our BUY rating on Kohl's Corp. (NYSE: KSS) and our target price of $65.

In our opinion, the company has the ability to boost sales by opening new stores and improving merchandise; the ability to make small improvements to industry-leading margins through inventory management and the sale of private-label merchandise; and the ability to deploy cash to open new stores, remodel existing ones and repurchase shares.

Kohl's faces strong competition from J.C. Penney, Target and an aspiring fashion merchant called Wal-Mart. For now, however, Kohl's seems to be making the right merchandising decisions in adding products from the likes of the Food Network, skateboarder Tony Hawk, designer Vera Wang, and TV starlet Lauren Conrad. The company must also compete with Macy's and Gap (which we believe will be trying hard to increase same-store sales at its Old Navy stores).

We advise potential buyers to prepare for additional volatility and the possibility that the retail environment could be more difficult than we currently expect.

Gauging the downside can be very difficult in a volatile market. We would consider lowering our rating if the company seemed to be losing market share, but for now, KSS is one of our favorite retailers. And management seems to be doing an excellent job executing its business plan. The company posted a very impressive increase in comparable sales for the year ended January 30, 2010, with a 4.5% increase in the fourth quarter. It also posted a 7.4% increase in the first quarter and a 4.6% increase in the second quarter. Our long-term rating for Kohl's remains BUY.

EARNINGS & GROWTH ANALYSIS

We are raising our FY11 earnings estimate to $3.72 per share from $3.65. The company's second-quarter sales rose 7.7% to $4.1 billion based on its July sales report. The quarterly gain was better than the 7% increase we expected.

For July, total sales increased 7.1% while comparable sales rose 4.1%, which was in line with consensus. The company said that it saw a high single-digit improvement in the number of transactions, offset by declines in average selling price and units per transaction.

This data doesn't contradict impressions from our store visits and industry observations. It's also fairly consistent with what we saw in the first quarter, when the 7.4% comp increase was driven by an 8.8% increase in transactions and a 1.4% decline in average transaction value.

Our impression is that convenient off-mall locations, updated store environments, effective promotions, and unique merchandise are bringing people in the door. At the same time, it appears that consumers remain cautious about spending and focused on value. We think that KSS is doing a good job delivering on some of the things that get people to open their wallets: good quality/value on basic items, fashionable merchandise that makes shoppers feel

Analyst's Notes...Continued

good, and merchandise that enhances shoppers' existing wardrobes by providing additional style options.

Kohl's raised its 2Q11 earnings guidance to $0.80-$0.82 per share from a previous range of $0.70-$0.75. Total sales growth came in about 70 basis points above the top of the company's guidance range. We're raising our estimate for the second quarter to $0.80 from $0.74 per share. Our increase assumes better sales than we initially expected, some additional expense leverage, and a slightly higher gross margin estimate. KSS will report on August 12.

Management said during the sales call that final numbers will probably show that inventories per store rose in the low single digits. That is a pretty good sign based on expected sales levels. Clearance inventories are likely to be up by slightly more than total inventories on a percentage basis. We don't think this is a big deal because KSS has reduced clearance inventories significantly over the last couple of years. Even though the percentage increase draws our attention, we don't believe that the change in actual units of merchandise is a major concern. Management said that clearance inventories represent less than 5% of total units on hand.

We are maintaining our FY12 EPS estimate of $4.00, and our five-year annual earnings growth rate forecast of 15%. The company's five-year plan has been to have about 1,400 stores in 2012. We still expect the company to reach 1,400, but it may take a little longer than management initially expected. The company ended 2Q with 1,089 stores. We expect the company to open about 30 stores in FY11 (representing an incremental 80 million square feet of selling space) and remodel about 85 stores. Management seems pleased with the productivity of the remodeled stores, and we believe that the company is learning how to complete the remodels more quickly and with less disruption.

We think the company can generate normalized same-store sales growth of about 3%-5%, repurchase shares, and boost operating margins slightly. There may be a few bounce-back quarters where sales grow at a faster rate. Our main focus is financial strength and sustainable profit growth. We don't think there has been a major change in the company's competitive position (if anything, it may have improved), so it wouldn't concern us if the company was a little slower in opening stores.

We remain fairly optimistic about the things management can control - such as inventory and costs - but same-store sales will obviously be the big swing factor. There is a lot of competition out there, and our recent store visits suggest that J.C. Penney's merchandise looks pretty good. We think Wal-Mart's selection of clothing is improving, but the giant hasn't had success with the fashionable designer merchandise that is helping Kohl's and JCP.

FINANCIAL STRENGTH

Our financial strength rating for Kohl's is Medium, the midpoint on our five-point scale. The total debt was about 20% of capital at the end of the first quarter. The company owns the real estate at about 36% of its stores, owns 25% of its stores on leased ground, and leases 39% of stores. At the end of fiscal 2010, the company had 717 stores in strip centers, 66 in malls and 221 in free-standing locations. This level of ownership doesn't rank in the top tier of retailers we follow, but we believe that it represents a significant asset. The company's balance sheet lists the net value of property and equipment at about $7 billion. We believe that about two-thirds of this value is in land and buildings. It is also encouraging that the vast majority of the company's book value is tangible.

We estimate the present value of operating leases at $6.8 billion. Treating these fixed obligations as debt would raise the company's debt to about 52% of capital, which is about average for the retailers we follow. EBIT covered net interest expense by a factor of about 14 in both FY09 and FY10, down from 29 in FY08 and 40 in FY07, but still extremely solid. Kohl's had about $2.4 billion in cash at the end of the quarter and another $318 million of long-term investments. The company's operating margin has generally been higher than those of other department stores, including Macy's and J.C. Penney, and near the top of the range for our coverage universe. We believe that Kohl's has a remaining authorization to repurchase about $1.87 billion of its stock. We expect the company to consider repurchasing shares with its growing cash balance, but believe that the company will probably want to have a new credit-card agreement before it redeploys this cash.

Fitch and S&P both rate the company's debt BBB+ and Moody's rating is Baa1. The outlooks are all stable. With debt at about 2.2-times adjusted EBITDAR at the end of FY10, we think management will try to maintain or slightly improve these ratings over the next few years.

With all of the recent credit turmoil, we're encouraged that the company has a $900 million line of credit through October 2011. The company had no borrowings on the credit line at the end of the first quarter. The company has said that it expects to use funds from operations to repay about $400 million of debt that is due in 2011.

MANAGEMENT & RISKS

In August 2008, Kevin Mansell replaced Lawrence Montgomery as CEO. He has also served as president (a title he retains) since 1999. He became chairman in September 2009. He joined the company as a divisional merchandise manager in 1982, and has worked in the retail industry for about 35 years. Wesley McDonald has been chief financial officer since July 2003. Prior to joining the company, he was chief financial officer at Abercrombie & Fitch from 2000-2003, and held various executive positions during his 12 years at Target Corp. He has more than 20 years of experience in the retail industry. Mr. McDonald is unique among CFOs of large retailers in that he handles most of the investor relations activity. We think his willingness to play that role is a positive for both the company and its shareholders.

In our view, the greatest risk for Kohl's is maintaining its niche in quality merchandise to value-conscious shoppers. The middle market, for apparel in particular, is a highly competitive business. The company must strike the right balance between exclusive brands and national brands and make sure that it doesn't abandon its core shopper as it attempts to add new and stylish merchandise. To date, it seems that the company has done a good job of giving core shoppers the merchandise they need with just enough sizzle to win additional business. In a tough economy, gaining additional sales can be the result of offering shoppers something that makes them feel happy and attractive while still coordinating with their existing wardrobe.

Kohl's faces pressure from full-line department stores and specialty retailers on the high end, J.C. Penney in the middle, and the discounters (Wal-Mart and Target) on the low end. We also believe that off-price retailers, such as T.J. Maxx, are a source of competition. With almost 20% of Kohl's sales coming from

Analyst's Notes...Continued

products for the home, the company also faces competition from Bed Bath & Beyond and Pottery Barn, as well as Target and JCP. We expect heightened competition in the market for home goods, as the housing market remains under pressure. The flip side is that this category could benefit from pent-up demand when the housing sector improves.

Management also faces execution risk with its aggressive building program, combined with the launch of the new product lines and the need to make the right fashion choices. To be sure, Kohl's has successfully defended its niche and expanded its base in the past.

Another risk is one that every retailer faces: the health of the overall economy and the strength of discretionary consumer spending. In 2006, the company sold its private-label credit accounts to JPMorgan Chase for about $1.6 billion. This probably slightly reduced the company's overall risk. The company is in the process of negotiating a new agreement.

We believe that less affluent customers have, at times, seen their budgets squeezed by higher energy prices, by restricted access to credit, and higher food prices. The business is also somewhat seasonal; about 15% of sales come during the back-to-school season and 30% during the Christmas holiday season.

COMPANY DESCRIPTION

Based in Menomonee Falls, Wisconsin, Kohl's Corp. operated 1,067 department stores at the end of the first quarter. The company's stores cater to middle-income customers shopping for their families and their homes. About one-third of the $17 billion of FY10 sales came from women's clothing, while menswear and products for the home contributed almost 20% each. About 47% of sales are from private brands and national brands that are tailored specifically for Kohl's, this is up from 25% in FY04. These include Simply Vera from Vera Wang, Dana Buchman, and Tony Hawk. The company operates about 79 million square feet of selling space.

Like other department stores, Kohl's uses a nine-box grid to plan its merchandise assortments. About 40% of merchandise is in the 'Classic' column, 40% is 'Modern Classic,' and 12% is 'Contemporary.' Some 45% of merchandise, like Lee jeans, falls in the 'Good' row; 40%, including Levi's, Jockey and Adidas are in the 'Better' row, and 15% of merchandise, including Chaps and Nike offerings, falls in the 'Best' row. Croft & Barrow, Sonoma and Apt.9 are the three largest private brands.

VALUATION

Kohl's shares are down about 1% in the last year. The shares trade at about 13-times our FY11 estimate and 12-times our FY12 forecast. We believe that the shares are attractively valued at a discount to the market multiple of 14-times our 2010 earnings estimate. In our opinion, there is upside to our earnings estimate as the economy stabilizes. Trading at 14-times trailing earnings, the shares are still below their five-year average of 17.8.

On a relative basis, the stock's trailing P/E is 5% below the trailing multiple of the S&P 500, and below the five-year average ratio of 1.1. The range is 0.66-1.61.

Using a multistage dividend discount model, we estimate a fair value for KSS above $65.

Based on our assumptions that EPS will increase 15% annually for the next five years and that the shares will trade at a terminal P/E of 15, a simple discounted earnings model puts the value of the shares at about $65.

The shares are trading at an enterprise value of about 7.3-times our EBIT estimate for FY11. We believe that high-quality retailers are attractive at less than 12-times trailing EBIT. The company's five-year average is 11. At 10-times our EBIT forecast for FY11, the shares would be worth about $66.

We are maintaining our target price of $65.

We advise potential buyers to prepare for volatility and the possibility that the macroeconomic environment could be more difficult than we currently expect.

On August 6, at midday, BUY-rated KSS traded at $48.37, down $0.63.

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About Argus

Argus Research, founded by Economist Harold Dorsey in 1934, has built a top-down, fundamental system that is used by Argus analysts. This six-point system includes Industry Analysis, Growth Analysis, Financial Strength Analysis, Management Assessment, Risk Analysis and Valuation Analysis.

Utilizing forecasts from Argus' Economist, the Industry Analysis identifies industries expected to perform well over the next one-to-two years.

The Growth Analysis generates proprietary estimates for companies under coverage.

In the Financial Strength Analysis, analysts study ratios to understand profitability, liquidity and capital structure.

During the Management Assessment, analysts meet with and familiarize themselves with the processes of corporate management teams.

Quantitative trends and qualitative threats are assessed under the Risk Analysis.

And finally, Argus' Valuation Analysis model integrates a historical ratio matrix, discounted cash flow modeling, and peer comparison.

THE ARGUS RESEARCH RATING SYSTEM

Argus uses three ratings for stocks: BUY, HOLD, and SELL. Stocks are rated relative to a benchmark, the S&P 500.

- A BUY-rated stock is expected to outperform the S&P 500 on a risk-adjusted basis over a 12-month period. To make this determination, Argus Analysts set target prices, use beta as the measure of risk, and compare expected risk-adjusted stock returns to the S&P 500 forecasts set by the Argus Market Strategist.
- A HOLD-rated stock is expected to perform in line with the S&P 500.
- A SELL-rated stock is expected to underperform the S&P 500.

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