

Carters, Inc. (CRI)

\$78.00 (As of 05/11/20)

Price Target (6-12 Months): **\$66.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 05/10/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:F

Value: F

Growth: F

Momentum: F

Summary

Shares of Carter's have lagged the industry in the past three months. The stock remains under pressure due to the ongoing global COVID-19 crisis, which has led to store closures across the United States and Canada. As a result, it withdrew 2020 view and expects the adverse impact to continue in the second quarter. Further, the company's bottom line lagged the Zacks Consensus Estimate in first-quarter 2020, while sales beat the same. Results were affected by store closures in North America, reduced wholesale sales and higher inventory stemming from the COVID-19 pandemic. Moreover, soft margins remained a drag. However, the company is gaining from rising demand for its products online, resulting in higher e-commerce sales. Also, omni-channel efforts such as the relaunch of the ship-in-store initiative bode well.

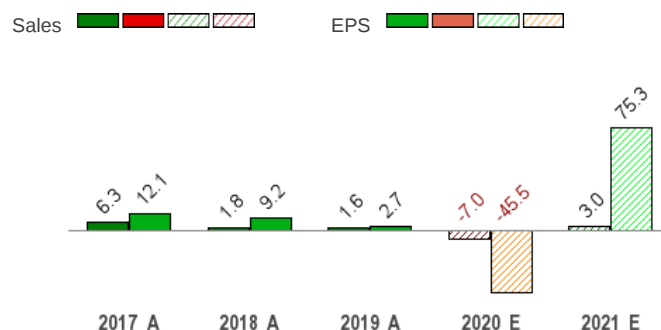
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$112.46 - \$60.17
20 Day Average Volume (sh)	567,414
Market Cap	\$3.4 B
YTD Price Change	-28.7%
Beta	1.24
Dividend / Div Yld	\$2.40 / 3.1%
Industry	Shoes and Retail Apparel
Zacks Industry Rank	Bottom 5% (240 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-370.0%
Last Sales Surprise	0.8%
EPS F1 Est- 4 week change	-41.9%
Expected Report Date	07/23/2020
Earnings ESP	0.0%
P/E TTM	16.2
P/E F1	22.2
PEG F1	2.9
P/S TTM	1.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021					3,371 E
2020	654 A	523 E	943 E	1,153 E	3,272 E
2019	741 A	734 A	943 A	1,101 A	3,519 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021					\$6.17 E
2020	-\$0.81 A	-\$0.34 E	\$1.84 E	\$3.15 E	\$3.52 E
2019	\$0.87 A	\$0.95 A	\$1.87 A	\$2.81 A	\$6.46 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/11/2020. The reports text is as of 05/12/2020.

Overview

Headquartered in Atlanta, GA, Carter's Inc. is the largest marketer of branded apparel and related products for babies, and young children in North America.

Notably, the company has a portfolio of popular brands, including Carter's, OshKoshB'gosh, Just One You, Child of Mine, Simple Joys, Skip Hop, and Precious Firsts. It sells the products through leading department stores, national chains and specialty retailers, both domestically and internationally. Additionally, Carter's showcases its products through company-operated stores in the United States, Canada and Mexico, and its websites namely www.carters.com, www.oshkoshbgosh.com and www.cartersoshkosh.ca.

The company generated \$3.5 billion in net sales in 2019. As of Mar 28, 2020, it operated 860 stores in the United States, 198 in Canada and 43 in Mexico.

Additionally, it had a solid wholesale presence in the United States (including department stores, national chain stores, specialty stores and discount retailers). It also operates through e-commerce sites in the United States, Canada and China as well as other international wholesale, licensing and online channels.

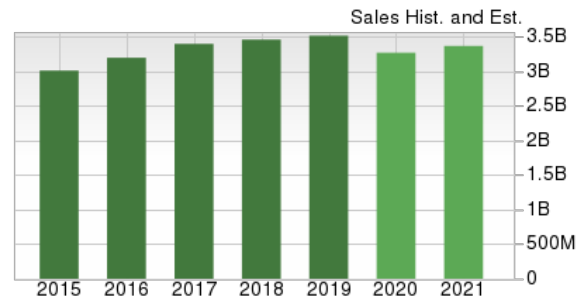
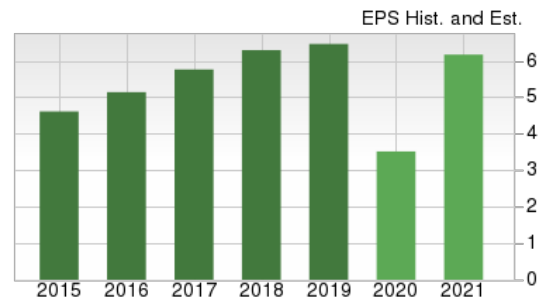
Of all the brands, Carter's and OshKoshB'gosh are the two most recognized and trusted names for young children's apparel. Among the rest, its Genuine Kids and Just One You brands are sold at Target, Child of Mine brand is sold at Walmart and Simple Joys brand is available on Amazon. The company's Skip Hop brand is a fast-growing global lifestyle brand and innovative leader in the children's durables product category.

The company's reportable segments include U.S. Retail, U.S. Wholesale and International.

The **U.S. Retail** segment includes the sale of its products through its U.S. retail and e-commerce websites.

The **U.S. Wholesale** segment consists of revenues, primarily from the sale of products to its U.S. wholesale partners.

The **International** segment comprises the sale of products outside the United States through its company and franchisee-operated retail stores in Canada and Mexico, e-commerce sites in Canada and China, and sales to its international wholesale customers.



Reasons To Sell:

▼ **Coronavirus Pandemic Hurts Q1 Performance, Stock Underperforms:** In response to the coronavirus outbreak, Carter's temporarily closed all stores in the United States and Canada starting from Mar 19. Store closures for the safety of employees and customers led to a decline in sales. Despite top line beat, sales fell 11.7% to \$654.5 million in first-quarter 2020. Moreover, the company reported adjusted loss of 81 cents against the Zacks Consensus Estimate of earnings of 30 cents in first-quarter 2020. Also, loss per share compared unfavorably to the year-ago quarter's earnings of 87 cents. The dismal performance can be attributed to store closures in North America, reduced wholesale sales and higher inventory stemming from the COVID-19 pandemic. Also, higher expenses hurt the bottom line to some extent. Notably, SG&A expenses rose 2.3% to roughly \$269.8 million.

Carter's sales for first-quarter 2020 were largely impacted by stores closures due to the coronavirus outbreak. It withdrew 2020 view anticipating supply-chain disruptions and other uncertainties.

Additionally, the company envisions the adverse impact of the pandemic to continue in the second quarter, with a potential recovery in the third quarter. Notably, the company has chosen to withdraw its 2020 guidance for the top and bottom lines, anticipating supply-chain disruptions and other unprecedented impacts related to COVID-19. Given this tough situation, shares of the company have plunged 29% in the past three months compared with the industry's decline of 14.7%.

▼ **Dismal Margin Trend:** Carter's has been witnessing soft margins for the past few quarters. Carter's gross margin contracted 770 basis points (bps) to 34.9% in first-quarter 2020 due to an increase in inventory and unfavorable mix of lower gross margin wholesale sales. Earlier, the metric contracted 70 bps, 50 bps and 140 bps in the fourth, second and first quarter 2019, respectively. Further, adjusted operating loss came in at \$26.3 million against adjusted operating income of \$60.3 million reported in the prior-year quarter due to reduced sales volume, a rise in inventory and elevated costs related to debt. Persistence of this trend may weigh on the company's profitability in the near term.

▼ **Debt Analysis:** Carter's long-term debt (including operating lease liabilities) of \$1,238.8 million as of Mar 28, 2020 surged almost two folds on a sequential basis from \$594.7 million. Moreover, its debt-to-capitalization of 0.74 stands higher than 0.61 reported in the prior quarter. Also, the company's times interest earned ratio of 6.2 as of Mar 28, 2020, portrays a sequential decline from 9.7. The times-interest-earned ratio is very important for some companies, as it measures a company's ability to meet its debt obligations based on its current income. Further, the company's debt load appears too high when compared with cash and cash equivalents of \$759.1 million. Higher debt level may adversely impact the company's creditworthiness and make it more susceptible to macro-economic factors and competitive pressures. To stay afloat amid the crisis, the company withdrew \$750 million from its revolving credit facility to add to its cash balance.

▼ **Macroeconomic Factors May Impact Discretionary Sales:** The company's customers remain sensitive to macroeconomic factors including interest rate hikes, increase in fuel and energy costs, credit availability, unemployment levels, and high household debt levels, which may negatively impact their discretionary spending, and in turn the company's growth and profitability.

Risks

- **Retail Strategy — Co-branded Stores:** Carter's Retail strategy remains focused on improving store productivity, strengthening e-commerce business and enhancing product offerings by introducing extended sizes for the Carter's brand and expanding Skip Hop brand offerings. The company had estimated net sales for Skip Hop to increase nearly 20% globally in 2019, contributing to total profitability. Additionally, the company is witnessing a positive response for its co-branded stores, which is a one-stop shop for families with young children. These stores have been the most productive lately, receiving the maximum return on investment. In the third quarter, co-branded stores were one of the best performing store types. The company opened four co-branded stores in Mexico during 2019. Moreover, it launched e-commerce operations in Mexico during the fourth quarter. Backed by the success of this store type, management plans to open more than 100 co-branded stores through 2024. Additionally, it earlier envisioned over 80% of its stores to be co-branded by 2021.
 - **E-commerce Growth:** Carter's is seeking opportunities to strengthen e-commerce capabilities through investments to speed up deliveries. The company's e-commerce operations performed well in the first quarter. Notably, e-commerce sales contributed nearly 20% to net sales in the first quarter, driven by robust online sales growth in children's apparel across the United States. Going ahead, management expects online sales to exceed \$1 billion in 2020 with increasing demand for products online. Notably, the company witnessed e-commerce growth in triple digits in recent weeks. Also, its exclusive brands have been witnessing the highest rate of growth online. Further, the company's brands are sold online at sites of its wholesale customers, the demand for which remained positive in the first quarter, which is likely to continue in the second quarter. Apart from these, Carter's move to re-launch its website and enhance its mobile app bodes well. Encouragingly, management has earlier anticipated e-commerce penetration to surge to 42% by 2024.
 - **Omni-Channel Capabilities:** Carter's has been making efforts to enhance omni-channel capabilities. In this regard, the company is gaining from its same-day pickup service for online orders, easy access to a broad array of online products when shopping in stores and easy access to its new credit card program. Given the current scenario, wherein retail stores remain closed and consumers are shifting preference to the online platform due to the ongoing pandemic, the company is now focusing on resuming its ship-from-store facility. This option is likely to be rolled out to 600 of its stores by this fall.
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Last Earnings Report

Carter's Posts Q1 Loss, Sales Surpass Estimates

Carter's reported a loss against the Zacks Consensus Estimate of earnings in the first quarter of 2020 while sales exceeded the same. Till early March, the company witnessed growth in line with its guidance and expected 2020 to perform well. Negative impacts from the ongoing COVID-19 pandemic begin to be felt in March, when sales slowed down due to consumers' increased awareness. The company suspended store operations for the safety of employees and customers due to which sales suffered a setback.

Quarter Ending **03/2020**

Report Date	May 05, 2020
Sales Surprise	0.78%
EPS Surprise	-370.00%
Quarterly EPS	-0.81
Annual EPS (TTM)	4.82

However, it is currently operating only online. Further, healthy demand from a few of its largest customers, such as Target and Walmart, comes as a relief. Nevertheless, the government has started lifting restrictions in some states, as a result of which management intends to reopen some stores. Despite this, management withheld its 2020 guidance for the top and bottom lines, anticipating supply-chain disruptions and other unprecedented impacts related to COVID-19. Additionally, it envisions the adverse impact to continue in the second quarter, with a potential recovery in the third quarter.

Q1 Highlights

Carter's reported first-quarter 2020 adjusted loss of 81 cents against the Zacks Consensus Estimate of earnings of 30 cents and the year-ago quarter's earnings of 87 cents. The decline can be attributed to store closures in North America, reduced wholesale sales and higher inventory stemming from the COVID-19 pandemic.

On a GAAP basis, the company reported adjusted loss per share of \$1.82 compared with earnings of 75 cents in the year-ago quarter.

Net sales declined 11.7% to \$654.5 million but surpassed the Zacks Consensus Estimate of \$649 million due to store closures in North America and soft wholesale demand stemming from the ongoing pandemic.

Segmental Sales

Sales at the **U.S. Retail** segment fell 14.9% year over year to \$320.7 million due to COVID-19 induced store closures, somewhat offset by sturdy sales in the e-commerce channel.

The **U.S. Wholesale** segment sales witnessed a decrease of 8.4% to \$252.1 million due to soft demand stemming from the closure of wholesale stores.

The **International** segment witnessed a 7.9% decline in revenues to \$81.6 million in the first quarter due to lower retail store sales in Canada along with a delay in shipments. Unfavorable currency movement hurt sales in the segment by 0.8%. Currency-neutral revenues for the segment fell 7.1%.

Margins

Gross profit decreased 27.7% year over year to \$228.3 million and gross margin contracted 770 basis points (bps) to 34.9%.

The company posted adjusted operating loss of \$26.3 million against adjusted operating income of \$60.3 million reported in the prior-year quarter. This is mainly due to reduced sales volume, a rise in inventory and elevated costs related to debt.

Balance Sheet & Shareholder-Friendly Moves

The company ended the quarter with cash and cash equivalents of \$759.1 million, net long-term debt of \$1,238.8 million and shareholders' equity of \$716 million. In the quarter under review, the company used cash flow of \$14.3 million for operating activities.

During the first quarter, Carter's returned nearly \$71.5 million to its shareholders through dividend payout and share buybacks. In the quarter, the company bought back 474,684 shares for \$45.3 million, the average price being \$95.34 per share. It paid out a dividend of 60 cents per share in the reported quarter.

However, management suspended its share repurchase plan on Mar 26. Post this, it has roughly \$650 million remaining under its existing share repurchase program. Also, the company decided to suspend its quarterly dividend on May 1.

Store Update

Carter's opened three retail stores and shuttered five in the United States in the first quarter. As of Mar 28, the company operated 860 retail stores in the United States alongside 198 in Canada and 43 in Mexico.

COVID-19 Update

In the wake of the ongoing pandemic, the company's stores across North America remain closed from Mar 19. However, it is operating through its online sites.

Keeping in these lines, the company witnessed robust demand from wholesale customers for its products online, which is likely to continue in the second quarter. Management projects more than \$1 billion of its brands to be sold online in 2020. Also, it is working toward implementing ship-from-store options in all stores and expects to roll out this facility in 600 stores by late fall.

Further, it has undertaken various steps to strengthen its financial position and provide some cushion to the top line. Notably, the company

withdrew the entire \$750 million from its revolving credit facility. Also, Carter's is planning to significantly lower its inventory.

Recent News

Carter's Extends Store Closure on Coronavirus Concerns - Apr 6, 2020

Carter's has decided to keep stores in North America closed until the situation normalizes. Due to extended store closures, management has put all store employees on leave from Apr 3. Although these employees will not receive their compensation for the furloughed period, they will be eligible for other employee benefits.

Apart from these, the company is making efforts to strengthen its financial position. Hence, it has cut down on inventories, capital spending and other expenses; revised payment conditions with vendors and landlords; implemented temporary pay cut and staff furloughs. Further, all hikes based on merits, incentives and 401(k) matching contributions have been suspended.

Carter's Withdraws Guidance on COVID-19 Impact - Mar 26, 2020

Carter's withdrew its first quarter and 2020 outlook due to the unprecedented impact of COVID-19. Also, management has withdrawn \$750 million available from its revolving credit facility in a bid to strengthen financial stability. Keeping in these lines, the company has decided to cut on its capital spending and other expenses along with inventory. Further, it has suspended its share repurchase program.

Prior to this, the company closed stores in United States and Canada starting from Mar 19 in order to curb the spread of COVID-19. During this time, all employees will be paid salaries and other benefits till early April. Moreover, employees are entitled to additional assistance if store closures are extended beyond April.

Valuation

Carter's shares are down 28.7% in the year-to-date period and 17.1% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are down 13.5% and 18.5%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry is up 6.6% but the sector is down 10.7%.

The S&P 500 index is down 9.1% in the year-to-date period but up 3.9% in the past year.

The stock is currently trading at 17.43X forward 12-month earnings, which compares to 27.87X for the Zacks sub-industry, 26.96X for the Zacks sector and 21.15X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.05X and as low as 9.31X, with a 5-year median of 15.73X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$66 price target reflects 14.75X forward 12-month earnings.

The table below shows summary valuation data for CRI

Valuation Multiples - CRI					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	17.43	27.87	26.96	21.15
	5-Year High	22.05	27.87	26.96	21.15
	5-Year Low	9.31	18.63	16.2	15.19
	5-Year Median	15.73	23.37	19.92	17.45
P/S F12M	Current	1.03	2.77	2.01	3.3
	5-Year High	1.81	2.9	3.2	3.44
	5-Year Low	0.76	1.99	1.67	2.54
	5-Year Median	1.33	2.59	2.53	3.02
EV/EBITDA TTM	Current	10.64	19.38	9.82	10.63
	5-Year High	14.34	24.5	17.63	12.86
	5-Year Low	8.08	12.39	8.28	8.28
	5-Year Median	10.98	16.01	12.32	10.77

As of 05/11/2020

Industry Analysis Zacks Industry Rank: Bottom 5% (240 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
AbercrombieFitch Company (ANF)	Neutral	3
Deckers Outdoor Corporation (DECK)	Neutral	4
The Gap Inc (GPS)	Neutral	3
Macys Inc (M)	Neutral	3
NIKE Inc (NKE)	Neutral	3
Ralph Lauren Corporation (RL)	Neutral	4
Steven Madden Ltd (SHOO)	Neutral	3
Caleres Inc (CAL)	Underperform	5

Industry Comparison Industry: Shoes And Retail Apparel				Industry Peers		
	CRI	X Industry	S&P 500	ANF	GPS	RL
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	3	3	4
VGM Score	F	-	-	A	A	A
Market Cap	3.40 B	1.39 B	19.55 B	686.20 M	2.85 B	5.12 B
# of Analysts	4	4.5	14	11	11	6
Dividend Yield	3.08%	1.20%	2.13%	7.18%	0.00%	3.96%
Value Score	F	-	-	A	A	A
Cash/Price	0.22	0.15	0.06	1.03	0.55	0.36
EV/EBITDA	9.78	7.67	11.85	6.15	6.85	5.93
PEG Ratio	2.89	1.95	2.60	NA	0.79	0.66
Price/Book (P/B)	4.75	1.53	2.71	0.65	0.86	1.64
Price/Cash Flow (P/CF)	8.85	9.05	10.71	3.15	2.20	6.24
P/E (F1)	22.16	18.53	19.55	NA	9.46	12.58
Price/Sales (P/S)	0.99	0.65	2.01	0.19	0.17	0.80
Earnings Yield	4.51%	5.40%	4.85%	-4.85%	10.56%	7.95%
Debt/Equity	2.63	0.64	0.76	1.39	2.04	0.65
Cash Flow (\$/share)	8.81	2.97	7.01	3.53	3.49	11.12
Growth Score	F	-	-	A	B	A
Hist. EPS Growth (3-5 yrs)	7.72%	7.23%	10.82%	-0.50%	-2.19%	1.80%
Proj. EPS Growth (F1/F0)	-45.59%	-43.27%	-9.99%	-173.47%	-58.84%	-23.20%
Curr. Cash Flow Growth	0.60%	0.43%	5.83%	-6.25%	-14.41%	9.60%
Hist. Cash Flow Growth (3-5 yrs)	6.40%	5.48%	8.52%	-5.89%	-5.36%	-3.42%
Current Ratio	3.72	1.90	1.27	1.55	1.41	1.94
Debt/Capital	72.48%	39.81%	44.41%	58.09%	67.08%	39.49%
Net Margin	4.39%	5.07%	10.59%	1.09%	2.14%	10.40%
Return on Equity	26.85%	16.18%	16.36%	4.61%	21.04%	20.83%
Sales/Assets	1.19	1.13	0.55	1.05	1.18	0.91
Proj. Sales Growth (F1/F0)	-7.02%	-2.50%	-2.41%	-9.85%	-11.29%	-5.31%
Momentum Score	F	-	-	F	C	D
Daily Price Chg	-1.60%	-1.25%	-0.95%	5.19%	-5.31%	-3.70%
1 Week Price Chg	5.55%	0.31%	3.23%	4.85%	3.45%	-1.38%
4 Week Price Chg	6.78%	2.79%	4.49%	1.27%	-7.92%	-8.64%
12 Week Price Chg	-29.28%	-28.84%	-20.09%	-35.76%	-57.72%	-43.03%
52 Week Price Chg	-17.10%	-26.43%	-7.00%	-57.30%	-66.27%	-41.32%
20 Day Average Volume	567,414	280,296	2,530,553	2,195,484	11,004,004	1,306,607
(F1) EPS Est 1 week change	-35.77%	0.00%	0.00%	0.00%	0.00%	-5.21%
(F1) EPS Est 4 week change	-41.88%	-16.03%	-6.07%	-189.22%	-18.24%	-17.39%
(F1) EPS Est 12 week change	-49.26%	-46.70%	-15.69%	-143.89%	-52.27%	-36.95%
(Q1) EPS Est Mthly Chg	-140.12%	-118.17%	-12.45%	-28.63%	-40.14%	-86.54%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	F
Momentum Score	F
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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