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Aug 20, 2020

Carters, Inc. (CRI)

$79.93 (As of 08/19/20)

Price Target (6-12 Months): **$84.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 07/10/20) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:A
	Value: B | Growth: A | Momentum: A	

Summary

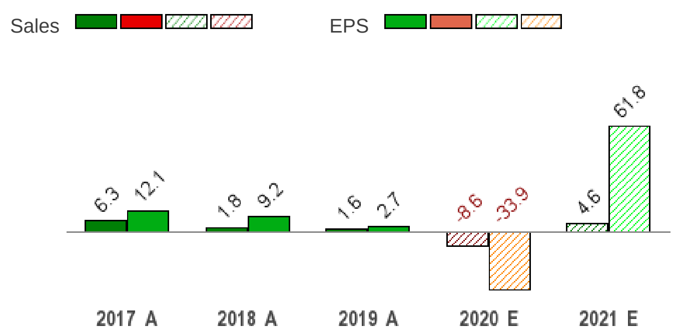
Shares of Carter's have lagged the industry year to date despite better-than-expected second-quarter 2020 results. Results were aided by solid demand in wholesale stores that remained open during the second quarter as well as robust e-commerce operations. Further, improving sales trends in the United States due to gradual reopening of stores contributed to the better than expected performance. Online sales are likely to exceed $1 billion in 2020 with increasing demand for products online, particularly baby, sleepwear, and playwear. Moreover, omni-channel efforts like relaunch of the ship-in-store and curbside pickup facilities bode well. However, the company's earnings and sales declined year over year driven by temporary closure of stores through most of the second quarter due to COVID-19. Also, currency headwinds remain a concern.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$112.46 - $60.17**
20 Day Average Volume (sh)	**664,988**
Market Cap	**$3.5 B**
YTD Price Change	**-26.9%**
Beta	**1.23**
Dividend / Div Yld	**$0.00 / 0.0%**
Industry	**Shoes and Retail Apparel**
Zacks Industry Rank	**Bottom 12% (223 out of 252)**
Last EPS Surprise	**242.1%**
Last Sales Surprise	**0.7%**
EPS F1 Est- 4 week change	**34.7%**
Expected Report Date	**10/22/2020**
Earnings ESP	**0.0%**
P/E TTM	**18.1**
P/E F1	**18.7**
PEG F1	**2.4**
P/S TTM	**1.1**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021					3,366 E
2020	654 A	515 A	920 E	1,129 E	3,218 E
2019	741 A	734 A	943 A	1,101 A	3,519 A

EPS Estimates

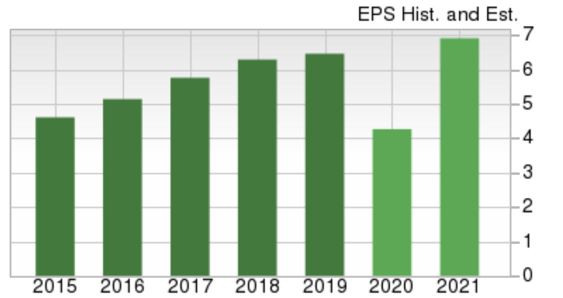
	Q1	Q2	Q3	Q4	Annual*
2021					$6.91 E
2020	-$0.81 A	$0.54 A	$1.59 E	$3.19 E	$4.27 E
2019	$0.87 A	$0.95 A	$1.87 A	$2.81 A	$6.46 A

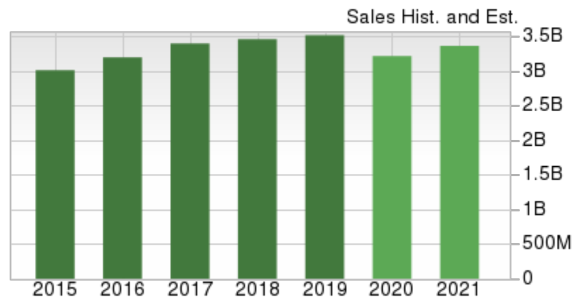
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/19/2020. The reports text is as of 08/20/2020.

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 Jun 27, 2020, it operated 1,100 stores in the United States, 196 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.

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 Buy:

> Strength in e-commerce business and increased demand for products online act as growth drivers for Carter's. Also, the company is likely to gain from its enhanced omni-channel facilities.

- **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 second quarter with comps growth of 101%. Notably, majority of sales were related to its ship-from-store facility. In fact, store fulfillment of its online purchases grew to 30% from 20% of e-commerce sales. It expects more than 70% of its stores to be able to fulfill online orders by August. Moving on, the company witnessed sturdy e-commerce demand in the wholesale channel to the tune of more than 100%, with its top wholesale customers recording triple-digit growth in online demand. Also, Carter's brands witnessed triple-digit growth in online demand despite lesser promotions. That said, online sales are expected to exceed $1 billion in 2020 with increasing demand for products online, particularly baby, sleepwear and playwear products. Encouragingly, management has earlier anticipated e-commerce penetration to surge to 42% by 2024.

- **Wholesale Business Aid**: Despite 80% of stores being closed during the second quarter and other COVID-19 impacts like supply-chain disruptions, Carter's posted better-than-expected second-quarter 2020 results. The company's results were aided by solid demand in wholesale stores that remained open during the second quarter along with robust e-commerce operations. Notably, the company continued to witness healthy demand from a few of its largest customers, like Target, Amazon and Walmart.

- **Store Reopening Bring Improved Trends in the United States**: With the lifting of government restrictions in some states, Carter's reopened several its stores across the United States by the end of June. In the United Sates, stores began reopening from early May and roughly 97% of stores were reopened by the end of the second quarter. Following store reopening, it is witnessed witnessing improved trends with healthy demand during the Jul 4 shopping season. Notably, the company recorded sturdy demand with comps growth of 8% in United States, driven by higher conversion and transaction which more than offset the drab traffic.

- **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. Even as stores have now reopened, consumers shift to the online platform due to the ongoing pandemic is likely to persist. As a result, the company is now focusing on its ship-from-store facility which is likely to be rolled out to 600 of its stores by this fall. Apart from these, management has introduced curbside pickup for customers' convenience.

- **Debt Analysis**: Carter's long-term debt (including operating lease liabilities) of $1,232.6 million as of Jun 27, 2020, fell 0.5% on a sequential basis from $1,238.8 million. Moreover, its debt-to-capitalization ratio is at a respectable 0.73 than 0.74 reported in the prior quarter. Further, the company had earlier suspended share repurchase and quarterly dividends on a temporary basis in a bid to combat this ongoing hurdle. Also, it did not incur any capital spending in the reported quarter. Out of $750 million of the revolving credit facility, the company has $501 million in unused borrowing capacity. Notably, management boasts liquidity of $1.5 billion at the end of the second quarter, which is likely to keep Carter's afloat during these trying times.

Reasons To Sell:

Carter's sales for second-quarter 2020 were largely impacted by store closures due to the coronavirus outbreak. Also, currency woes remain a concern.

- **Store Closures Hurt Q2 Sales**: Shares of Carter's declined 26.9% year to date against the industry's growth of 2.7%. Despite earnings and sales beat, both the metrics declined year over year during the second quarter. Net sales decreased 29.9% due to store closures in North America, particularly in April and May, as well as soft wholesale demand stemming from the pandemic. Further, sales at the U.S. Retail, U.S. Wholesale and International segments witnessed a decrease of 25.3%, 33.8% and 29.9% year over year, respectively. The downside was mainly due to COVID-19-induced store closures since mid-March, which extended to April and most of May. Moreover, the company has refrained from providing any full-year guidance citing the unprecedented impacts of COVID-19 and uncertainty related to market recovery.

- **Dismal Operating Margin in Q2**: During the second-quarter 2020, Carter's adjusted operating income came in at $41.1 million, declining 35.6% year over year from $63.8 million reported in the prior-year quarter. Additionally, adjusted operating margin of 8% contracted 70 bps from 8.7% reported in the last-year quarter. This is mainly due to reduced sales volume and sluggish royalty income, somewhat offset by reduced SG&A expenses and a solid gross margin.

- **Currency Headwinds**: Carter's remains exposed to unfavorable foreign-currency impacts, which hurt the international segment to some extent, particularly Brazil and Argentina. Any fluctuation in foreign currency may act as a deterrent in the near term.

- **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.

Last Earnings Report

Carter's Earnings & Sales Surpass Estimates in Q2

Quarter Ending	06/2020
Report Date	Jul 24, 2020
Sales Surprise	0.72%
EPS Surprise	242.11%
Quarterly EPS	0.54
Annual EPS (TTM)	4.41

Carter's posted better-than-expected second-quarter 2020 results. However, both top and bottom lines declined year over year. Despite 80% of stores being closed during this period and other COVID-19 impacts like supply-chain disruptions, results benefited from solid demand in wholesale stores that remained open during the second quarter along with robust e-commerce operations.

Moreover, it continued to witness healthy demand from a few of its largest customers, like Target, Amazon and Walmart. With the lifting of government restrictions in some states, the company reopened several its stores across the United States by the end of June. Further, it is witnessed improved trends with healthy demand during the Jul 4 shopping season.

However, the company has refrained from providing any full-year guidance citing the unprecedented impacts of COVID-19 and uncertainty related to market recovery.

Q2 Highlights

Carter's reported second-quarter 2020 adjusted earnings of 54 cents per share, exceeding the Zacks Consensus Estimate of loss of 38 cents. However, the figure declined 43.2% year over year from 95 cents in the prior- year quarter. On a GAAP basis, the company reported adjusted earnings per share of 19 cents, down 80.4% from 97 cents in the year-ago quarter.

Net sales decreased 29.9% to $514.9 million but surpassed the Zacks Consensus Estimate of $511 million. The year over year decline was due to store closures in North America, particularly in April and May, as well as soft wholesale demand stemming from the pandemic.

Segmental Sales

Sales at the **U.S. Retail** segment fell 25.3% year over year to $316 million due to COVID-19-induced store closures since mid-March, which extended in to April and most of May. However, stores began reopening from early May and roughly 97% of stores were reopened by the end of the second quarter. Following store reopening, it witnessed sturdy demand with comps growth of 8% in the quarter, driven by higher conversion and transaction which more than offset the drab traffic.

The **U.S. Wholesale** segment sales witnessed a decrease of 33.8% to $151.7 million due to the closure of the majority of wholesale stores for most of the second quarter along with delayed shipments.

The **International** segment witnessed a 29.9% decline in revenues to $514.9 million in the second quarter due to lower retail store sales in Canada and Mexico along with a delay in shipments stemming from the COVID-19 pandemic.

Margins

Gross profit decreased 27.1% year over year to $235.5 million, while gross margin expanded 170 basis points (bps) to 45.7%. The uptick can be attributable to improved pricing efforts and better inventory management.

The company's adjusted operating income came in at $41.1 million, declining 35.6% year over year from $63.8 million reported in the prior-year quarter. Additionally, adjusted operating margin of 8% contracted 70 bps from 8.7% reported in the last-year quarter. This is mainly due to reduced sales volume and sluggish royalty income, somewhat offset by reduced SG&A expenses and a solid gross margin. SG&A expense fell 18.6% to $218.1 million in the quarter.

Balance Sheet & Shareholder-Friendly Moves

The company ended the quarter with cash and cash equivalents of $1 billion, net long-term debt of $1,232.6 million and shareholders' equity of $733.3 million. In the first half of 2020, the company provided cash flow of $238.8 million for operating activities.

Earlier, Carter's had suspended share repurchase and quarterly dividends on a temporary basis. Also, it did not incur any capital spending in the reported quarter.

Out of $750 million of the revolving credit facility, the company has $501 million in unused borrowing capacity. Notably, management boasts liquidity of $1.5 billion at the end of the second quarter, which is likely to keep Carter's afloat during these trying times.

Store Update

Carter's intends to close more than 200 stores, which accounts for nearly 25% of its total stores in North America, by 2024. As of Jun 27, the company operated 1,100 retail stores in the United States, Canada and Mexico.

Valuation

Carter's shares are down 26.9% in the year-to-date period and 11% over the trailing 12-month period. Stocks in the Zacks sub-industry is up 2.7% but the Zacks Consumer Discretionary sector is down 4.4%, in the year-to-date period. Over the past year, the Zacks sub-industry and the sector are up 26.7% and 5.4%, respectively.

The S&P 500 index is up 4.7% in the year-to-date period and 15.6% in the past year.

The stock is currently trading at 13.44X forward 12-month earnings, which compares to 36.19X for the Zacks sub-industry, 33.9X for the Zacks sector and 22.78X for the S&P 500 index.

Over the past five years, the stock has traded as high as 20.87X and as low as 9.31X, with a 5-year median of 14.7X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $84 price target reflects 14.12X forward 12-month earnings.

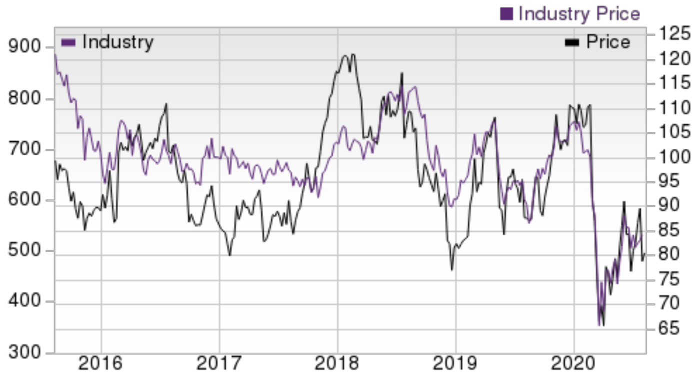
The table below shows summary valuation data for CRI

Valuation Multiples - CRI

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	13.44	36.19	33.9	22.78
	5-Year High	20.87	36.19	33.9	22.78
	5-Year Low	9.31	18.63	16.13	15.25
	5-Year Median	14.7	23.51	19.86	17.58
P/S F12M	Current	1.05	3.35	2.4	3.7
	5-Year High	1.71	3.35	2.95	3.7
	5-Year Low	0.76	2.04	1.68	2.53
	5-Year Median	1.3	2.68	2.5	3.05
EV/EBITDA TTM	Current	10.92	31.9	11.19	12.76
	5-Year High	14.34	31.9	17.84	12.85
	5-Year Low	8.08	12.75	8.34	8.25
	5-Year Median	10.92	16.5	12.23	10.91

As of 08/19/2020

Industry Analysis **Zacks Industry Rank:** Bottom 12% (223 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Deckers Outdoor Corporation **(DECK)**	Outperform	2
AbercrombieFitch Company **(ANF)**	Neutral	4
Caleres, Inc. **(CAL)**	Neutral	4
The Gap, Inc. **(GPS)**	Neutral	4
Macys, Inc. **(M)**	Neutral	4
NIKE, Inc. **(NKE)**	Neutral	4
Steven Madden, Ltd. **(SHOO)**	Neutral	4
Ralph Lauren Corporation **(RL)**	Underperform	4

Industry Comparison Industry: Shoes And Retail Apparel

	CRI	X Industry	S&P 500	ANF	GPS	RL
				Industry Peers		
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Underperform
Zacks Rank (Short Term)	3	-	-	4	4	4
VGM Score	A	-	-	F	F	D
Market Cap	3.49 B	1.48 B	23.61 B	635.69 M	5.56 B	4.93 B
# of Analysts	3	6	14	10	9	6
Dividend Yield	0.00%	0.00%	1.65%	0.00%	0.00%	0.00%
Value Score	B	-	-	D	D	C
Cash/Price	0.27	0.24	0.07	1.06	0.19	0.53
EV/EBITDA	9.37	7.10	13.36	5.53	9.53	8.76
PEG Ratio	2.37	3.16	2.99	NA	NA	6.10
Price/Book (P/B)	4.76	1.36	3.16	0.80	2.38	1.93
Price/Cash Flow (P/CF)	9.07	8.75	12.71	2.92	4.27	6.40
P/E (F1)	18.20	30.56	21.82	NA	NA	60.40
Price/Sales (P/S)	1.09	0.85	2.47	0.19	0.38	0.95
Earnings Yield	5.34%	2.67%	4.37%	-28.20%	-16.20%	1.66%
Debt/Equity	2.53	0.48	0.76	1.78	2.84	1.23
Cash Flow ($/share)	8.81	2.85	6.94	3.53	3.49	10.55
Growth Score	A	-	-	F	F	F
Hist. EPS Growth (3-5 yrs)	5.03%	2.97%	10.44%	2.25%	-1.21%	-1.38%
Proj. EPS Growth (F1/F0)	-33.95%	-42.86%	-5.97%	-497.95%	-222.11%	-82.95%
Curr. Cash Flow Growth	0.60%	0.00%	5.22%	-6.25%	-14.41%	-10.72%
Hist. Cash Flow Growth (3-5 yrs)	6.40%	5.48%	8.52%	-5.89%	-5.36%	-4.88%
Current Ratio	2.69	2.50	1.33	1.32	1.23	2.59
Debt/Capital	71.64%	42.21%	44.50%	63.97%	73.96%	55.19%
Net Margin	3.57%	2.84%	10.13%	-5.50%	-5.47%	2.67%
Return on Equity	25.14%	8.64%	14.67%	-14.29%	-8.63%	8.21%
Sales/Assets	1.05	1.05	0.51	0.98	1.08	0.70
Proj. Sales Growth (F1/F0)	-8.56%	-0.40%	-1.54%	-14.42%	-18.39%	-27.45%
Momentum Score	A	-	-	C	C	D
Daily Price Chg	-1.82%	0.00%	-0.38%	-0.39%	-0.53%	-1.39%
1 Week Price Chg	4.61%	2.45%	1.09%	9.29%	7.10%	7.13%
4 Week Price Chg	-8.07%	0.61%	2.23%	3.51%	15.98%	-5.34%
12 Week Price Chg	-10.06%	0.00%	6.91%	-20.92%	40.78%	-16.48%
52 Week Price Chg	-11.00%	-11.00%	2.28%	-37.79%	-12.26%	-22.42%
20 Day Average Volume	664,988	262,448	1,899,976	2,158,285	9,852,597	1,294,766
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-0.23%	0.00%
(F1) EPS Est 4 week change	34.74%	0.00%	1.70%	-3.97%	-1.79%	-60.25%
(F1) EPS Est 12 week change	21.39%	-12.73%	3.08%	-236.02%	-981.16%	-72.18%
(Q1) EPS Est Mthly Chg	NA%	-3.00%	0.83%	-64.58%	-4.76%	-57.98%

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	B
Growth Score	A
Momentum Score	A
VGM Score	A

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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