Feb 21, 2020

Carters, Inc. (CRI)

$111.35 (As of 02/20/20)

Price Target (6-12 Months): **$117.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 05/01/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: D | Growth: F | Momentum: D	**4-Sell** VGM:F

Summary

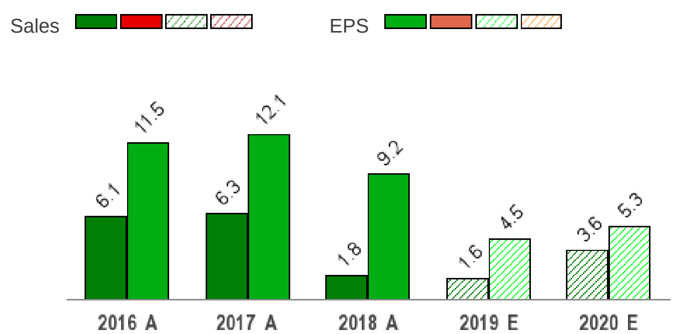
Shares of Carter's have increased in the past three months, driven by its robust earnings trend. The company reported positive earnings surprise for the fourth straight time in third-quarter 2019 driven by robust demand for its merchandise. It expects favorable trends in the U.S. Retail and Wholesale businesses to continue driving top and bottom lines throughout 2019. The company's efforts to enhance omni-channel and e-commerce capabilities bode well. Further, its co-branded stores are likely to aid sales. However, the company is exposed to tariff threats, due to the introduction of tariffs on List 4 goods. It expects negative impacts of tariff to be around $4 million in the fourth quarter. Also, adverse currency rates are hurting the company's performance. Moreover, it expects high inventory levels to persist in 2019.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$112.46 - $81.54**
20 Day Average Volume (sh)	**356,767**
Market Cap	**$4.9 B**
YTD Price Change	**1.8%**
Beta	**0.91**
Dividend / Div Yld	**$2.00 / 1.8%**
Industry	**Shoes and Retail Apparel**
Zacks Industry Rank	**Bottom 34% (169 out of 255)**
Last EPS Surprise	**10.7%**
Last Sales Surprise	**0.9%**
EPS F1 Est- 4 week change	**-0.1%**
Expected Report Date	**02/24/2020**
Earnings ESP	**0.5%**
P/E TTM	**17.1**
P/E F1	**16.1**
PEG F1	**2.1**
P/S TTM	**1.4**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	773 E	751 E	978 E	1,142 E	3,643 E
2019	741 A	734 A	943 A	1,098 E	3,517 E
2018	756 A	696 A	924 A	1,086 A	3,462 A

EPS Estimates

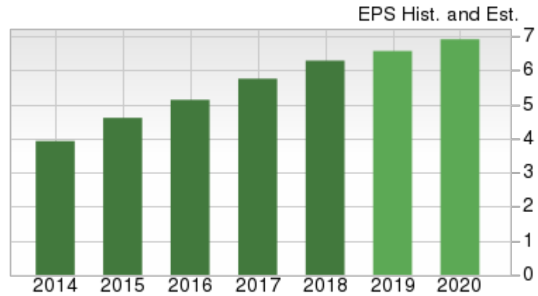
	Q1	Q2	Q3	Q4	Annual*
2020	$0.95 E	$1.00 E	$1.95 E	$3.13 E	$6.92 E
2019	$0.87 A	$0.95 A	$1.87 A	$2.89 E	$6.57 E
2018	$1.09 A	$0.79 A	$1.61 A	$2.84 A	$6.29 A

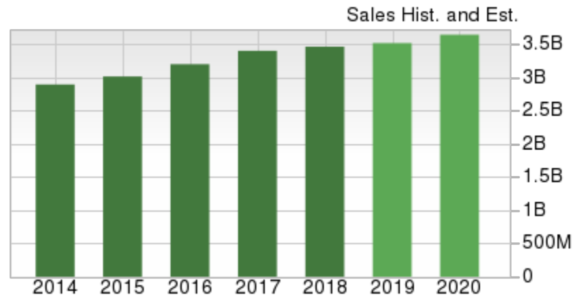
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/20/2020. The reports text is as of 02/21/2020.

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 2018. As of Jun 29, 2019, it operated 833 stores in the United States, 189 in Canada and 42 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:

Carter's Retail strategy is focused on improving store productivity, strengthening e-commerce business and enhancing product offerings for the Carter's and Skip Hop brands.

▲ **Positive Earnings Trend:** Carter's is witnessing robust earnings surprise trend. Notably, the company reported fourth straight quarter of positive earnings surprise in third-quarter 2019. Earnings gained from solid growth in the U.S. Retail and Wholesale businesses along with robust demand for its merchandise. Moreover, management issued guidance for fourth-quarter 2019 and revised its full-year view. For the fourth quarter, the company anticipates top-line growth of roughly 1%. Further, adjusted earnings are expected to improve nearly 1% from $2.84 reported in fourth-quarter 2018. For 2019, the company projects net sales growth of 1.5%, which is at the mid-point of the previously mentioned 1-2% growth. Adjusted earnings per share are expected to rise 4% from $6.29 earned in 2018. We note that, shares of Carter's have gained 9.7% in the past three months, compared with the industry's growth of 8.6%.

▲ **Strong Q3 Margins:** Carter's discontinued with its soft margin trends in third-quarter 2019. The company's gross profit improved 3.8% to $402.2 million and gross margin expanded 40 basis points (bps) to 42.6%. The increase in gross margin was driven by higher realized pricing and improved product margins, mainly in U.S. Retail segment. Adjusted operating income grew 7.1% to $114.7 million. Adjusted operating margin expanded 60 bps to 12.2%, backed by improved gross margin and cost leverage.

▲ **Sturdy Retail Strategy:** 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, it 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 two new co-branded stores in Mexico during the third quarter. In the fourth quarter, the company expects to open two more co-branded store locations in Mexico. Backed by the success of these stores, management plans to open more than 100 co-branded stores in the next five years. Additionally, it envisions over 80% of its stores to be co-branded by 2021.

▲ **Omni-Channel Capabilities & E-commerce:** Carter's is seeking opportunities to strengthen e-commerce capabilities through investments to speed up deliveries. Notably, the company registered double-digit growth in e-commerce sales in the third quarter, with e-commerce penetration improving to 30% of sales. E-commerce investments in the past year included re-launch of its website in summer, better engagement for online customers and higher conversion rates. Additionally, the company is making investments to strengthen its mobile app, which is likely to be re-launched in 2020. Further, its brands are sold online at sites of its wholesale customers. On a combined basis (including sales at its website and through wholesale customers), the company expects total online sales of its brands to exceed $1 billion in fiscal 2020.

Moreover, 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. This has led to an increase of 13% in multi-channel customers driven by improved experiences.

Reasons To Sell:

- **High Inventory Levels:** High inventory levels are devastating concern for retailers, as it indicates that the company is struggling to make sales. This could result in higher inventory costs overtime that may hurt gross margins. This is also true for Carter's, which witnessed 4.4% growth in net inventories in the third quarter. This growth is mainly due to rise in wholesale demand and new retail stores, lower provisions for inventory, and product cost increase. Although, the company's excess inventory levels were significantly lower than the same period last year, it still anticipates mid-single-digit rise in inventories at year end.

Carter's is facing tariff threats to the tune of $100 million annually. For fourth-quarter 2019, the company expects negative impacts of tariff to be approximately $4 million.

- **Tariffs a Woe:** After negotiations with suppliers and significant pricing actions, Carter's has reduced exposure to unmitigated tariff threats to $30 million annually from $100 million impact expected earlier. To battle the cost increase, the company has significantly lowered exposure to goods sourced from China, reducing it to 15% heading into 2020 compared with 26% at the beginning of 2019. Although supply-chain initiatives and other efforts in this direction have helped mitigate this hurdle to some extent, the company still remains exposed to additional tariffs. For fourth-quarter 2019, the company expects negative impacts of tariff to be approximately $4 million.

- **Currency Headwinds Hurt Q3 Earnings:** Carter's third-quarter results were affected by negative movements in foreign currency. Notably, unfavorable foreign-currency impacts hurt the top line by $1.3 million (0.1%). Sales for the international segment were also partly dented by currency headwinds. 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 its growth and profitability.

Last Earnings Report

Carter's Beats on Q3 Earnings & Sales, Revises 2019 View

Quarter Ending	09/2019
Report Date	Oct 24, 2019
Sales Surprise	0.92%
EPS Surprise	10.65%
Quarterly EPS	1.87
Annual EPS (TTM)	6.53

Carter's reported third-quarter 2019 results, wherein top and bottom lines surpassed the Zacks Consensus Estimate and improved year over year. Results reflected strong retail and wholesale businesses along with robust demand for its fall and holiday season merchandise. Further, management updated view for 2019.

Q3 Highlights

Carter's third-quarter 2019 adjusted earnings of $1.87 per share grew 16% year over year. Moreover, the bottom line surpassed the Zacks Consensus Estimate of $1.69.

Including a non-cash impairment charge of nearly 53 cents for the Skip Hop tradename, the company reported earnings per share of $1.34 on a GAAP basis. This compared unfavorably with $1.53 earned in the year-ago quarter.

Net sales grew 2.1% to $943.3 million and beat the Zacks Consensus Estimate of $941 million, driven by growth in retail and wholesale segments, and strong demand for its fall and holiday season merchandise. However, unfavorable foreign currency affected the top line by $1.3 million (0.1%). Sales advanced 2.2% on a constant-currency basis.

Segmental Sales

Sales at the U.S. Retail segment rose 1.1% year over year to $464.1 million. Comparable sales (comps) declined 0.6%, owing to lower in-store sales, offset by growth in e-commerce sales.

The U.S. Wholesale segment witnessed sales growth of 3.9% to $352.3 million, owing to sturdy demand for the exclusive Carter's brand.

The International segment witnessed nearly 1% rise in revenues to $127 million in the third quarter due to growth in markets outside North America, partly offset by the change in business model in China and effects of negative currency. Currency-neutral revenues for the segment rose 1.9%. Foreign currency marred the segment's sales by $1.3 million or 1%.

Margins

Gross profit improved 3.8% to $402.2 million and gross margin expanded 40 basis points (bps) to 42.6%. Adjusted operating income grew 7.1% to $114.7 million. Adjusted operating margin expanded 60 bps to 12.2%, backed by improved gross margin and cost leverage.

Balance Sheet & Shareholder-Friendly Moves

The company ended the quarter with cash and cash equivalents of $153.9 million, net long-term debt of $769.5 million, and shareholders' equity of $812.7 million. Inventories as of Sep 28, 2019, increased 4.4% to $723.2 million.

In the first three quarters of 2019, the company generated $73.4 million in operating cash flow. Capital expenditure in the quarter totaled $46.1 million.

During the quarter, Carter's returned nearly $77 million to its shareholders, including $22.3 million in dividend payout and $55 million of share buybacks. The company bought back 602,043 shares for $55 million, the average price being $91.39 per share. As of Oct 23, 2019, Carter's had $230 million remaining under its current share-repurchase program. It paid out a dividend of 50 cents per share in the reported quarter.

Store Update

In the third quarter, Carter's opened 14 retail stores and shut three in the United States. As of Sep 28, 2019, the company operated 845 retail stores in the United States alongside 198 in Canada and 44 in Mexico.

Outlook

Following the strong third quarter, management issued guidance for fourth-quarter 2019. It also revised view for the year. For the fourth quarter, the company anticipates top-line growth of roughly 1%. Further, adjusted earnings are expected to improve nearly 1% from $2.84 reported in fourth-quarter 2018.

For 2019, the company now projects net sales growth of 1.5%, which is at the mid-point of the previously mentioned 1-2% growth. Adjusted earnings per share are now expected to rise 4% compared with 4-6% growth stated earlier. In 2018, the company reported earnings of $6.29 per share.

Earnings view excludes a $30.8 million impairment charge related to the write-down of the Skip Hop tradename asset, $7.8 million charge related to the early removal of debt, $1.6 million of restructuring costs, $2.1 million benefit from the sale of inventory in China, and the $0.7 million reversal of store restructuring expenses recorded in third-quarter 2017.

Valuation

Carter's shares are up 1.8% in the year-to-date period and nearly 20.4% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Discretionary sector are up 0.5% and 0.6% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and the sector are up 19.6% and 11.4%, respectively.

The S&P 500 index is up 4.7% in the year-to-date period and 20.1% in the past year.

The stock is currently trading at 15.92X forward 12-month earnings, which compares to 26.05X for the Zacks sub-industry, 20.33X for the Zacks sector and 19.31X for the S&P 500 index.

Over the past five years, the stock has traded as high as 22.05X and as low as 11.4X, with a 5-year median of 15.92X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $117 price target reflects 16.73X 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	15.92	26.05	20.33	19.31
	5-Year High	22.05	26.48	23.34	19.34
	5-Year Low	11.4	18.63	16.15	15.18
	5-Year Median	15.92	23.23	20.06	17.47
P/S F12M	Current	1.35	3.07	2.32	3.56
	5-Year High	1.81	3.07	3.19	3.56
	5-Year Low	0.97	1.99	1.81	2.54
	5-Year Median	1.35	2.58	2.54	3
EV/EBITDA TTM	Current	12.57	24.71	12.45	12.31
	5-Year High	14.14	24.71	17.67	12.85
	5-Year Low	8.37	13.14	10.77	8.47
	5-Year Median	11.14	15.97	12.4	10.72

As of 02/20/2020

Industry Analysis Zacks Industry Rank: Bottom 34% (169 out of 255)

Top Peers

Deckers Outdoor Corporation **(DECK)**	Outperform
Ralph Lauren Corporation **(RL)**	Outperform
Abercrombie & Fitch Company **(ANF)**	Neutral
Caleres, Inc. **(CAL)**	Neutral
The Gap, Inc. **(GPS)**	Neutral
NIKE, Inc. **(NKE)**	Neutral
Steven Madden, Ltd. **(SHOO)**	Neutral
Delta Apparel, Inc. **(DLA)**	Underperform

Industry Comparison Industry: Shoes And Retail Apparel

Industry Peers

	CRI Neutral	X Industry	S&P 500	ANF Neutral	GPS Neutral	RL Outperform
VGM Score	F	-	-	B	C	B
Market Cap	4.92 B	1.86 B	24.34 B	1.07 B	6.52 B	8.99 B
# of Analysts	3	5	13	10	7	4
Dividend Yield	1.80%	0.96%	1.78%	4.69%	5.55%	2.26%
Value Score	D	-	-	A	A	B
Cash/Price	0.03	0.06	0.04	0.38	0.16	0.21
EV/EBITDA	12.91	12.00	14.18	7.52	6.45	10.30
PEG Ratio	2.08	1.68	2.09	0.91	1.14	1.62
Price/Book (P/B)	6.05	2.17	3.30	1.08	1.79	2.88
Price/Cash Flow (P/CF)	13.20	9.90	13.49	4.75	4.38	10.95
P/E (F1)	15.97	16.10	19.28	13.87	10.28	15.59
Price/Sales (P/S)	1.40	0.95	2.68	0.30	0.40	1.41
Earnings Yield	6.21%	6.21%	5.17%	7.21%	9.73%	6.42%
Debt/Equity	1.80	0.55	0.70	1.48	1.90	0.65
Cash Flow ($/share)	8.44	2.68	7.03	3.59	3.98	11.12
Growth Score	F	-	-	F	F	B
Hist. EPS Growth (3-5 yrs)	10.56%	8.64%	10.84%	-3.52%	-2.48%	1.80%
Proj. EPS Growth (F1/F0)	5.24%	10.65%	7.09%	81.54%	-5.91%	8.69%
Curr. Cash Flow Growth	5.75%	7.54%	6.72%	8.78%	13.35%	9.60%
Hist. Cash Flow Growth (3-5 yrs)	7.77%	6.27%	8.25%	-7.00%	-2.78%	-3.42%
Current Ratio	2.53	1.68	1.22	1.41	1.43	1.94
Debt/Capital	64.26%	39.81%	42.37%	59.75%	65.50%	39.49%
Net Margin	7.68%	6.85%	11.56%	1.52%	4.97%	10.40%
Return on Equity	35.47%	15.20%	16.80%	5.30%	22.33%	20.83%
Sales/Assets	1.35	1.25	0.55	1.13	1.31	0.91
Proj. Sales Growth (F1/F0)	3.57%	5.69%	3.90%	1.98%	0.36%	0.50%
Momentum Score	D	-	-	A	C	F
Daily Price Chg	0.56%	0.00%	0.01%	1.19%	1.69%	1.72%
1 Week Price Chg	3.54%	-0.22%	1.65%	4.39%	1.62%	1.06%
4 Week Price Chg	2.49%	-4.21%	0.36%	-1.10%	-1.91%	3.25%
12 Week Price Chg	7.33%	-6.54%	4.39%	1.85%	3.31%	12.10%
52 Week Price Chg	23.13%	-8.91%	15.29%	-14.88%	-29.50%	-3.47%
20 Day Average Volume	356,767	60,019	1,992,841	1,612,924	4,359,894	965,782
(F1) EPS Est 1 week change	-0.14%	0.00%	0.00%	0.57%	0.00%	-2.65%
(F1) EPS Est 4 week change	-0.14%	-0.14%	-0.02%	0.57%	-0.06%	1.63%
(F1) EPS Est 12 week change	-0.18%	-0.11%	-0.17%	-1.36%	1.61%	1.63%
(Q1) EPS Est Mthly Chg	-2.06%	-2.06%	-0.48%	0.00%	0.00%	-34.34%

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	D
Growth Score	F
Momentum Score	D
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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