

## Carter's Inc

## Conference Takeaways: Positive tone on consumer, but questions remain on DTC

Maintain Rating: UNDERPERFORM | PO: 65.00 USD | Price: 87.92 USD

## Consumer sentiment seems to be improving

We hosted Mike Casey (Chairman/CEO), Richard Westenberger (CFO/COO), and Kendra Krugman (Chief Creative and Growth Officer) for investor meetings at our Consumer Conference in Miami. We were encouraged by the company's positive tone regarding an improving outlook for the consumer and optimism on product changes, but we see better risk/reward elsewhere in our coverage universe with the stock at 9x EV/EBITDA (and 14x P/E) until the company can show that retail sales trends are improving.

## Wholesale destocking cycle likely over

We thought mgmt. struck an encouraging tone about the outlook for its wholesale business, stating order books coming in for winter and holiday look consistent with the bookings through Fall (which are up LSD). This outlook represents about 2/3rds of CRI's wholesale business (seasonal bookings) and could sway better/worse depending on replenishment trends. We think the exclusive business (business to Walmart, Target, and Amazon) could outperform the total wholesale sales guidance this year of LSD growth but expect structural challenges at other retailers could limit upside for the segment.

## Waiting for an inflection to positive comps

Mgmt. remains confident about achieving its LSD comp growth this year (includes guidance of down MSD to HSD in 1Q) given changes they have made to the business. This includes personnel changes (has led to improved product), merchandising changes (select stores now segmented by age), and store fleet optimization. We remain cautious about underwriting such a material improvement of the business without seeing signs that comps and the children's apparel category overall is improving; we remain wary that part of CRI's wholesale success could be cannibalizing their own retail business.

## GM expansion led by visibility in lower product costs

Mgmt. reiterated expectations for F24 product costs to decline by MSD, led by lower ocean freight rates in 1H24 (we estimate roughly \$13mn cost savings), lower cotton costs, and less off-price business. We forecast GM expansion this year (+110bp to 48.5%) will be offset by a like amount of SG&A deleverage given continued investments in stores, labor, marketing, and incentives. Downside risk to our margin forecast includes deeper pricing cuts than the 1% decline embedded in the guidance.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	6.90	6.19	6.30	6.78	7.22
GAAP EPS	6.37	6.24	6.30	6.78	7.22
EPS Change (YoY)	-12.3%	-10.3%	1.8%	7.6%	6.5%
Consensus EPS (Bloomberg)			6.35	6.67	7.53
DPS	3.00	3.00	3.20	3.20	3.20
Valuation (Dec)					
P/E	12.7x	14.2x	14.0x	13.0x	12.2x
GAAP P/E	13.8x	14.1x	14.0x	13.0x	12.2x
Dividend Yield	3.4%	3.4%	3.6%	3.6%	3.6%
EV / EBITDA*	8.1x	9.3x	9.3x	9.0x	8.7x
Free Cash Flow Yield*	1.5%	14.5%	6.1%	7.3%	7.6%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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## Equity

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## Stock Data

Price	87.92 USD
Price Objective	65.00 USD
Date Established	5-Jan-2024
Investment Opinion	B-3-7
52-Week Range	60.66 USD - 88.03 USD
Mkt Val (mn) / Shares Out (mn)	3,238 USD / 36.8
Free Float	97.1%
Average Daily Value (mn)	65.68 USD
BofA Ticker / Exchange	CRI / NYS
Bloomberg / Reuters	CRI US / CRI.N
ROE (2024E)	25.4%
Net Dbt to Eqty (Dec-2023A)	17.1%
ESGMeter™	High

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LSD: low single digit

MSD: mid single digit

HSD: high single digit

# iQprofile<sup>SM</sup> Carter's Inc

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	13.9%	13.4%	13.1%	13.1%	13.0%
Return on Equity	30.6%	27.3%	25.4%	25.1%	24.2%
Operating Margin	12.1%	11.1%	11.1%	11.2%	11.2%
Free Cash Flow	48	469	199	237	246

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.3x	2.3x	1.3x	1.4x	1.4x
Asset Replacement Ratio	0.7x	1.0x	1.3x	1.2x	1.1x
Tax Rate	21.3%	23.1%	24.0%	24.0%	24.0%
Net Debt-to-Equity Ratio	50.5%	17.1%	17.5%	13.1%	7.8%
Interest Cover	9.3x	11.2x	12.0x	12.3x	12.7x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	3,213	2,946	2,930	2,989	3,052
% Change	-7.9%	-8.3%	-0.5%	2.0%	2.1%
Gross Profit	1,472	1,396	1,422	1,453	1,487
% Change	-11.4%	-5.2%	1.8%	2.2%	2.3%
EBITDA	452	393	392	408	418
% Change	-24.0%	-13.1%	-0.3%	4.0%	2.6%
Net Interest & Other Income	(42)	(28)	(27)	(25)	(25)
<b>Net Income (Adjusted)</b>	<b>268</b>	<b>227</b>	<b>223</b>	<b>231</b>	<b>236</b>
% Change	-20.8%	-15.5%	-1.7%	3.7%	2.4%

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	246	228	223	231	236
Depreciation & Amortization	62	60	63	68	72
Change in Working Capital	0	0	0	0	0
Deferred Taxation Charge	(1)	(1)	0	1	1
Other Adjustments, Net	(218)	241	(7)	17	17
Capital Expenditure	(40)	(60)	(80)	(80)	(80)
<b>Free Cash Flow</b>	<b>48</b>	<b>469</b>	<b>199</b>	<b>237</b>	<b>246</b>
% Change	-79.2%	877.7%	-57.7%	19.1%	3.8%
Share / Issue Repurchase	(296)	(96)	(96)	(96)	(96)
Cost of Dividends Paid	(118)	(112)	(113)	(109)	(105)
Change in Debt	(396)	(120)	1	1	1

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	212	351	342	375	421
Trade Receivables	199	184	183	186	190
Other Current Assets	778	566	593	605	617
Property, Plant & Equipment	190	183	200	212	221
Other Non-Current Assets	1,061	1,094	1,094	1,095	1,096
<b>Total Assets</b>	<b>2,440</b>	<b>2,379</b>	<b>2,412</b>	<b>2,474</b>	<b>2,546</b>
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	529	512	506	514	523
Long-Term Debt	617	497	498	499	500
Other Non-Current Liabilities	76	75	75	76	78
<b>Total Liabilities</b>	<b>1,643</b>	<b>1,533</b>	<b>1,528</b>	<b>1,539</b>	<b>1,550</b>
<b>Total Equity</b>	<b>801</b>	<b>855</b>	<b>894</b>	<b>945</b>	<b>1,006</b>
<b>Total Equity &amp; Liabilities</b>	<b>2,445</b>	<b>2,389</b>	<b>2,422</b>	<b>2,484</b>	<b>2,556</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Apparel

## Company Description

Carter's Inc is the largest branded marketer in the US of apparel exclusively for babies and young children. They own the Carter's and OshKosh brands and distribute their products through department stores, chain and specialty stores, discount retails and operate their own branded strip center and outlet retail stores.

## Investment Rationale

We think the risk/reward is skewed to the downside as we see risk to margins from a more normalized promotional environment, think the success of price increases is dependent on peer behavior, and see continued competition from private label.

## Stock Data

Average Daily Volume

767,931

## Quarterly Earnings Estimates

	2023	2024
Q1	0.98A	0.81E
Q2	0.64A	1.01E
Q3	1.84A	1.89E
Q4	2.76A	2.63E



## Price objective basis & risk

### Carter's Inc (CRI)

Our \$65 price objective is based on a 7x EV/EBITDA ('24E) multiple, lower than its historical average given the ongoing macro uncertainty and downside EPS risks.

Upside risks to our price objective are better-than-expected children's apparel sales, successful market share gains through the company's Age Up strategy, and a more defensive business model during a potential recession.

Downside risks to our price objective are emphasis by wholesale partners on private label, exposure to weakening outlet centers, and a heightened competitive pricing environment.

## Analyst Certification

I, Christopher Nardone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Softline Retailing and Dept Stores Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Amer Sports Inc	AS	AS US	Lorraine Hutchinson, CFA
	Bath & Body Works Inc	BBWI	BBWI US	Lorraine Hutchinson, CFA
	Burlington Stores	BURL	BURL US	Lorraine Hutchinson, CFA
	Crocs, Inc.	CROX	CROX US	Christopher Nardone
	Deckers Outdoor Corp	DECK	DECK US	Christopher Nardone
	European Wax Center	EW CZ	EW CZ US	Lorraine Hutchinson, CFA
	lululemon athletica Inc	LULU	LULU US	Lorraine Hutchinson, CFA
	Oddity Tech	ODD	ODD US	Lorraine Hutchinson, CFA
	PVH Corp	PVH	PVH US	Christopher Nardone
	Ralph Lauren	RL	RL US	Christopher Nardone
	Ross Stores Inc	ROST	ROST US	Lorraine Hutchinson, CFA
	Tapestry Inc.	TPR	TPR US	Lorraine Hutchinson, CFA
	TJX Companies	TJX	TJX US	Lorraine Hutchinson, CFA
	Urban Outfitters	URBN	URBN US	Lorraine Hutchinson, CFA
<b>NEUTRAL</b>				
	American Eagle	AEO	AEO US	Christopher Nardone
	Birkenstock	BIRK	BIRK US	Lorraine Hutchinson, CFA
	FIGS, Inc.	FIGS	FIGS US	Alice Xiao
	Foot Locker	FL	FL US	Lorraine Hutchinson, CFA
	Levi Strauss & Co.	LEVI	LEVI US	Christopher Nardone
	Nike	NKE	NKE US	Lorraine Hutchinson, CFA
	Signet Jewelers	SIG	SIG US	Lorraine Hutchinson, CFA
	Skechers USA Inc	SKX	SKX US	Christopher Nardone
	Ulta Beauty	ULTA	ULTA US	Lorraine Hutchinson, CFA
	Under Armour Inc	UAA	UAA US	Lorraine Hutchinson, CFA
<b>UNDERPERFORM</b>				
	Aritzia	YATZ	ATZ CN	Alice Xiao
	Aritzia	ATZAF	ATZAF US	Alice Xiao
	Carter's Inc	CRI	CRI US	Christopher Nardone
	Gap Inc.	GPS	GPS US	Lorraine Hutchinson, CFA
	Kohl's	KSS	KSS US	Lorraine Hutchinson, CFA
	Nordstrom	JWN	JWN US	Lorraine Hutchinson, CFA
	Revolve	RVLV	RVLV US	Alice Xiao
	V F Corp	VFC	VFC US	Lorraine Hutchinson, CFA
	Victoria's Secret & Co	VSCO	VSCO US	Alice Xiao
<b>RSTR</b>				
	Macy's	M	M US	Lorraine Hutchinson, CFA

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**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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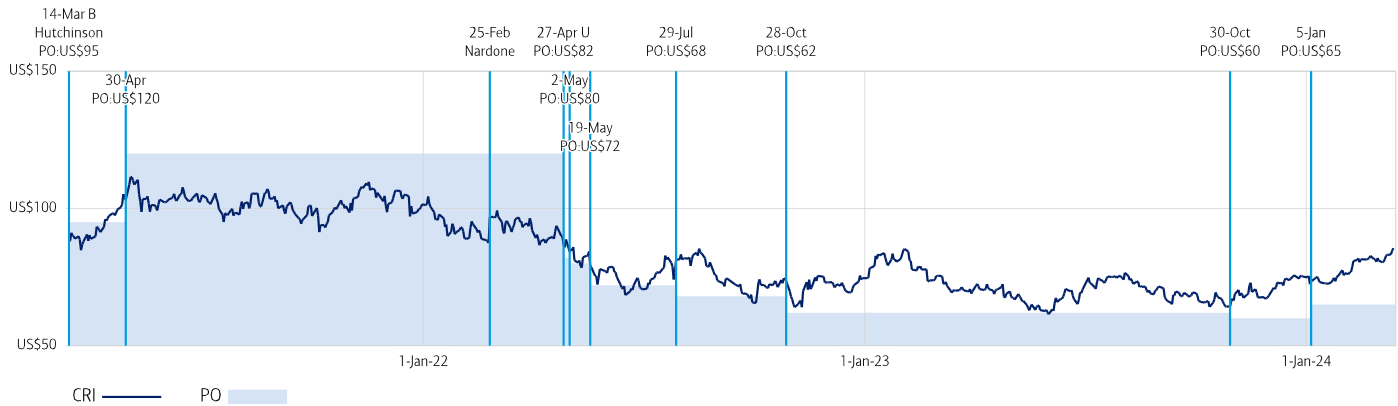
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### Carter's Inc (CRI) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Textiles/Apparel Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	13	52.00%	Buy	8	61.54%
Hold	6	24.00%	Hold	3	50.00%
Sell	6	24.00%	Sell	2	33.33%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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