Kontoor Brands Inc. (KTB)

Updated September 28th, 2019 by Jonathan Weber

Key Metrics

Current Price:	$35	**5 Year CAGR Estimate:**	11.5%	**Volatility Percentile:**	0.1%
Fair Value Price:	$40	**5 Year Growth Estimate:**	4.0%	**Momentum Percentile:**	45.9%
% Fair Value:	87%	**5 Year Valuation Multiple Estimate:**	2.9%	**Growth Percentile:**	26.1%
Dividend Yield:	6.4%	**5 Year Price Target**	$49	**Valuation Percentile:**	79.8%
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Total Return Percentile:**	77.3%

Overview & Current Events

Kontoor Brands markets itself as a "global lifestyle apparel company". The company, which was spun off from V.F. Corporation (VFC) on May 22nd, 2019, owns some of the world's most iconic denim brands, including *Wrangler, Lee,* and *Rock & Republic.* Last year, the company generated $2.7 billion in revenue, with 27% of its revenue generated outside of the United States. Kontoor Brands currently employs approximately 17,000 people and trades with a market capitalization of $2.0 billion.

Kontoor Brands reported its second quarter financial results on August 8. The company reported that its revenue declined by 8.2% in the quarter compared to the previous year. Revenues still came in higher than what the analyst community had forecasted, though, beating the estimate by $18 million.

Kontoor Brands' earnings-per-share totaled $0.96 during the second quarter, easily beating the analyst consensus estimate by $0.29. The company not only faced declining revenues during the quarter, it also had to battle margin headwinds. This is why Kontoor Brands' EBITDA margin declined by 60 base points year over year, combined with the revenue decline, this resulted in a 10% decline in the company's adjusted EBITDA, to $82 million.

Kontoor Brands reaffirmed its 2019 financial guidance with the publication of its quarterly earnings release. The company expects 2019 revenue to exceed $2.5 billion, which reflects a mid-single digit decline compared to 2018's comparable figure. The revenue decline is attributable to foreign exchange fluctuations, prior year customer bankruptcies, and strategic business exists. Adjusted EBITDA, meanwhile, is expected to fall into a range of $340 million to $360 million, which reflects a mid-single-digit to low-double-digit decline year-on-year.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	***$3.10***	***$3.77***
DPS	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	***$2.24***	***$2.24***
Shares[1]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	***56.6***	***56.6***

Kontoor Brands was spun off very recently, thus there is no long-term data available. We are estimating $3.10 in earnings-per-share for the full fiscal year for Kontoor Brands. In the near-term, the company is likely to experience some meaningful earnings growth as it sheds the one-time costs associated with its restructuring and begins operating as a steady-state publicly-traded company. Beyond that, Kontoor Brands is likely to grow very slowly, due to the fact that its brands and products are inherently slow-growth, while the company also does not retain a large amount of earnings that could be spent on growth initiatives. We are estimating 4% earnings growth over the next five years, which includes a meaningful post-spinoff consolidation. Earnings growth beyond that point is likely to be materially lower. The near term growth estimate is partially based on management's belief that Kontoor Brands will be able to grow its revenues at a low-single-digit pace in 2020 and 2021, while adjusted EBITDA is forecasted to grow at a mid-single-digit pace during those years, thanks to some margin improvements and operating leverage.

[1] In Millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	***11.3***	***13.0***
Avg. Yld.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	***6.4%***	***4.6%***

Finding a fair value for Kontoor Brands is more difficult compared to most marketable securities because it does not have any history as a standalone company for us to rely on. One useful tool, however, is to look at the historical valuation of its prior parent company, V.F. Corporation. V.F. Corporation has traded at an average price-to-earnings ratio of 17.6 over the last decade. Given that Kontoor Brands was created to separate V.F. Corporation's slow-growing legacy brands from its faster-growing core businesses, we believe a somewhat lower valuation multiple is warranted for the spinoff company. Our fair value estimate for Kontoor Brands is a price-to-earnings ratio of 13.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	***72.3%***	***59.4%***

Kontoor Brands will pay out about three-quarters of this year's profits in the form of dividends in 2019. With Kontoor Brands, the company's dividend safety is an extraordinarily important component of its investment case because the company's total returns will be heavily reliant upon the continued distribution of its dividend payment. We still recommend investors monitor the safety of the company's dividend closely moving forward.

Kontoor Brands' competitive advantage lies in its ownership of some of the world's most popular denim brands. *Lee's* and *Wrangler* in particular control a large amount of market share in the denim category.

Final Thoughts & Recommendation

Kontoor Brands is an interesting investment opportunity that was created through a low-growth spin-off. We believe that the company's earnings will be substantially higher than what its Q1 results would have suggested. The company's strong 6.4% dividend yield appears to be well-covered by the firm's free cash flow. Kontoor Brands seems capable of delivering low-double-digit total returns over the coming years, which is why we rate the stock a buy.

Total Return Breakdown by Year