# Kontoor Brands Inc. (KTB)

*Updated November 9th, 2019 by Jonathan Weber*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $36 | **5 Year CAGR Estimate:** | 11.2% | **Volatility Percentile:** | 0.1% |
| **Fair Value Price:** | $40 | **5 Year Growth Estimate:** | 4.0% | **Momentum Percentile:** | 25.5% |
| **% Fair Value:** | 89% | **5 Year Valuation Multiple Estimate:** | 2.3% | **Growth Percentile:** | 28.1% |
| **Dividend Yield:** | 6.2% | **5 Year Price Target** | $49 | **Valuation Percentile:** | 83.5% |
| **Dividend Risk Score:** | F | **Retirement Suitability Score:** | C | **Total Return Percentile:** | 84.1% |

## Overview & Current Events

Kontoor Brands is an apparel company that focuses on what it calls "lifestyle apparel". The company, which was spun off from V.F. Corporation (VFC) in 2019, owns some of the world's most iconic denim brands, including *Wrangler, Lee,* and *Rock & Republic.* Kontoor Brands is a US-focused company; just 27% of its revenues are generated outside of the United States. Kontoor trades with a market capitalization of $2.1 billion and is headquartered in Greensboro, North Carolina.

Kontoor Brands reported its third quarter financial results on November 7. The company reported that its revenue declined by 9.4% compared to the previous year's quarter, to $638 million. Revenues came in $8 million lower than what the analyst community had forecasted. Kontoor Brands' revenues were negatively impacted by its decision to close down non-profitable business lines, mainly in India, while currency rate movements also were a headwind.

Kontoor Brands' earnings-per-share totaled $0.95 during the third quarter, beating the analyst consensus estimate by $0.07. Kontoor Brands' lower revenue generation was partially offset by a higher average gross margin during the quarter. Kontoor Brands did, however, also have to deal with the impact of one-time expenses related to the closing of some businesses, which is why its operating margins were down compared to the previous year's quarter.

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. Kontoor Brands also expects EBITDA of $340 million to $350 million.

## 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*** | ***$2.60*** |
| **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, but it is likely that Kontoor Brands' business would face steep headwinds in a major recession such as the last financial crisis.

In 2020, Kontoor Brands 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.

Management's believes that Kontoor Brands will be able to grow its revenues at a low-single-digit pace in 2020 and 2021, while adjusted EBITDA is forecast to grow at a mid-single-digit pace during those years, thanks to some margin improvements and operating leverage. Management has also stated that capital expenditures will be relatively low going forward, at well below $100 million per year. This means that most of the company's cash flows can be returned to its owners via dividends and buybacks, which should be beneficial for total returns.

[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 | ***11.6*** | ***13.0*** |
| **Avg. Yld.** | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A | ***6.2%*** | ***5.3%*** |

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 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%*** | ***68.9%*** |

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 a highly 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 thus 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 rise over the coming years, thanks to buybacks and the fading of one-time expenses. The company's strong 6.2% 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