Bears See Kontoor Brands Declining

Ticker/Price: KTB ($37.78)

Analysis:

Kontoor Brands (KTB) with the March $40 put open interest rising to 3,676 today after 1,675 added at $7.40 on 10/15 following 2000 that opened on 10/1, over $3.3M position in the ITM puts. KTB shares have rallied sharply since bottoming in June following its spin-odd earlier this year from VF Corp (VFC). The $2.14B apparel company operates under the Wrangler and Lee brands and trades 10.2X Earnings, 0.8X Sales, and 8.8X EV/EBITDA. KTB saw a number of insider purchases in August for around $700,000 in stock in the $29.96 to $33.15 range. KTB sees revenues growing just 1.3% in 2020 after a 6.8% decline expected for 2019. KTB has more than $300M in operating cash flows and investing in a more efficient supply chain with more than $50M in cost reductions identified which will help improve margins. The company expects to add new product, channel, and geographies over the next couple years. They note that a number of headwinds over the last couple years are episodic and not likely to recur in 2019 (de-stocking, India demonetization, and exiting the Argentina business). KTB also has a large 5.92% dividend yield. Analysts have an average target of $33 and short interest is at 6.7% of the float. KTB will next report on 11/7 and is coming off a very impressive quarter beating estimates, though revenues were down 8.2% Y/Y, so a low bar. Guggenheim has a buy rating noting long-term positive outlook based on 1) attractive top-line growth opportunities, globally, 2) a history of resilient and stable cash flow generation, and 3) a secure dividend. SIG started shares positive in June with a $36 target citing an attractive dividend yield, superior management team, and a sales and margin turnaround story with limited downside. It sees little risk to Kontoor's initial FY19 sales and EBITDA guidance, which completes the rollout of a global ERP platform, headwinds from Sear's bankruptcy, and Walmart de-stocking. BAML is more cautious seeing risks to the turnaround story with guidance assuming 2H sales acceleration though the environment is turning more competitive. It also notes a challenging retail environment, an overly optimistic growth plan, marketing underinvestment, and weakness in the international business.

Hawk Vision:

Hawk's Perspective: KTB looks like a justifiable short play considering the weak growth and retail environment, though a large dividend yield likely limits downside potential, but a move back to $32 looks achievable.

Confidence Ranking: $$