

HEDGEYE

RISK MANAGEMENT

CRI MARGIN REBOUND DISCONNECT

OCTOBER 15 2012

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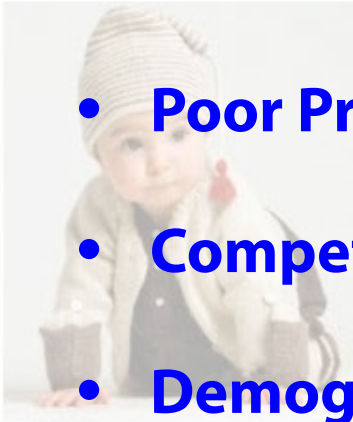
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CRI MARGIN REBOUND DISCONNECT

Key Highlights

- **Poor Product Differentiation**
- **Competitive Landscape Heating Up**
- **Demographic Inflection Underway**
- **The Margin Rebound Disconnect**
- **Asset Intensity Rising**



CRI: MARGIN REBOUND DISCONNECT

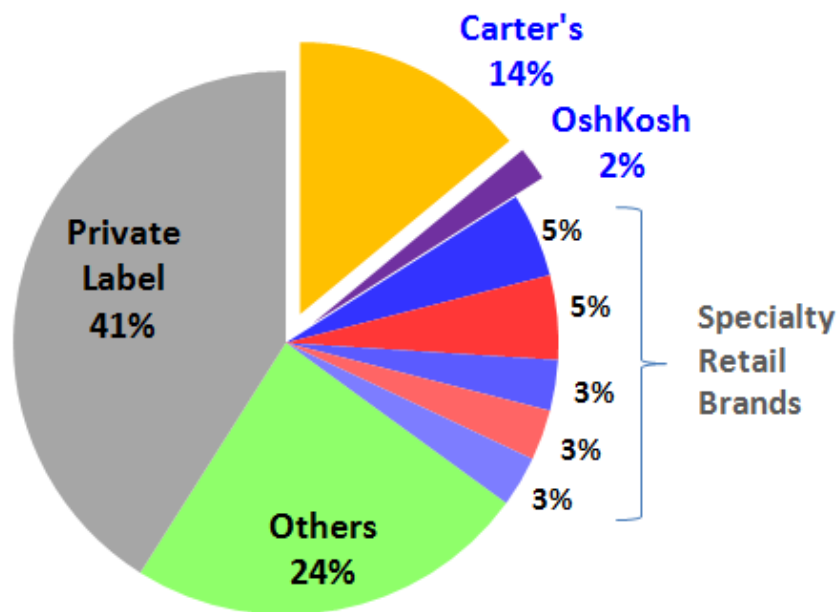
Poor Product Differentiation

Channel	Nike	Ralph Lauren	Carter's
Company Direct Best	 \$150.00	 \$3,000.00	 \$15.60
Specialty Retail Better	 \$109.99 -27%	 \$225.00 -93%	
Mass/Dept Good	 \$55.00 -63%	 \$17.00 -99%	 \$10.00 -36%
Online	 \$114.95 -23%	 \$1,125.00 \$99.99 -97%	 \$26.00 \$14.99 -4%

Where's the product/pricing stratification?

Poor Product Differentiation

\$22Bn U.S. Children's Apparel Market

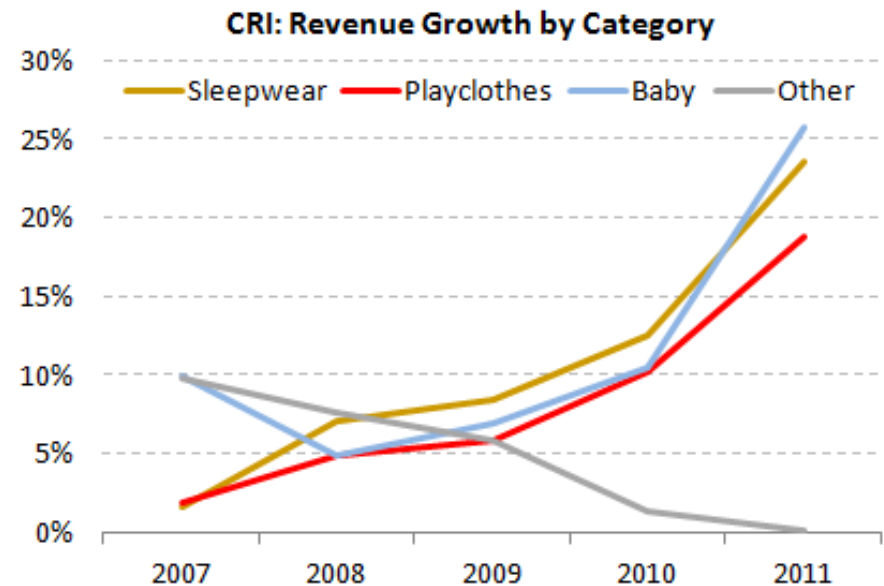
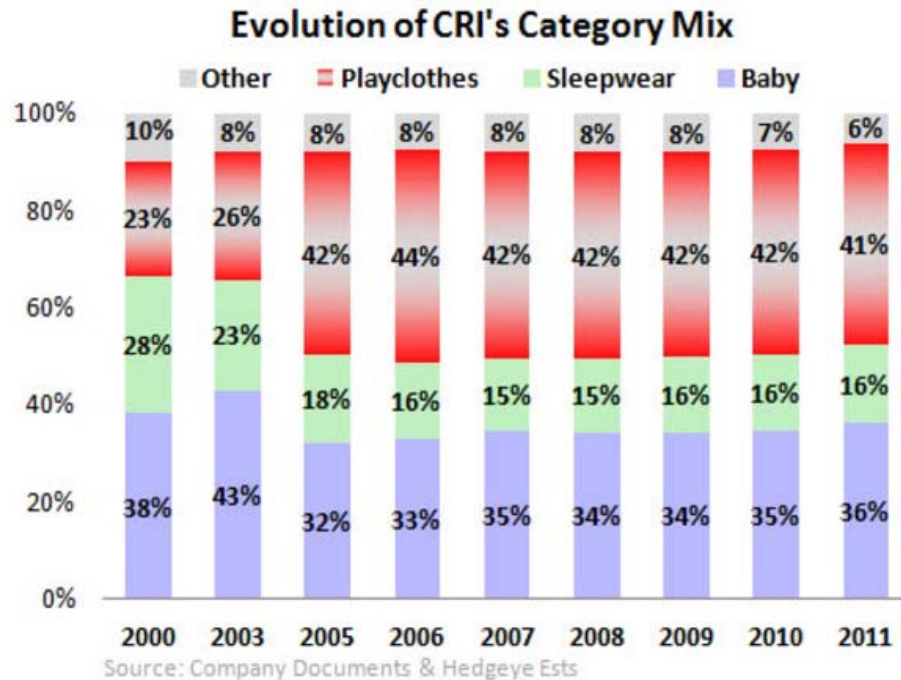


Source: Company Documents, NPD Group

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With fewer heavy hitters in Kids Apparel does it matter?

Competitive Landscape Heating Up



Playwear has nearly doubled as a percent of CRI's total over the past ten years.

In Playwear CRI competes with everything from Children's Place, to Old Navy, to Disney and Wal-Mart private label. Not a place to hang your hat on.

Competitive Landscape Heating Up

Giggle JCP Shop Rendering



NYC Giggle Store



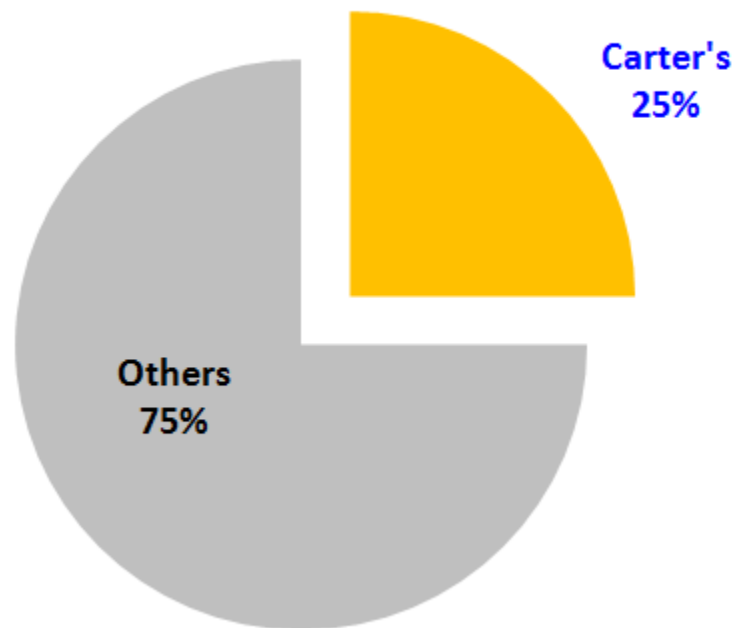
Little Gilt

We have our very own kids' clothes, fabrics, plus we have perfectly snuggle-friendly (some pieces are everyday necessities that are affordable)

Now we're seeing more competition in the Baby category as well.

Competitive Landscape Heating Up

~\$3Bn U.S. Infant Apparel Market

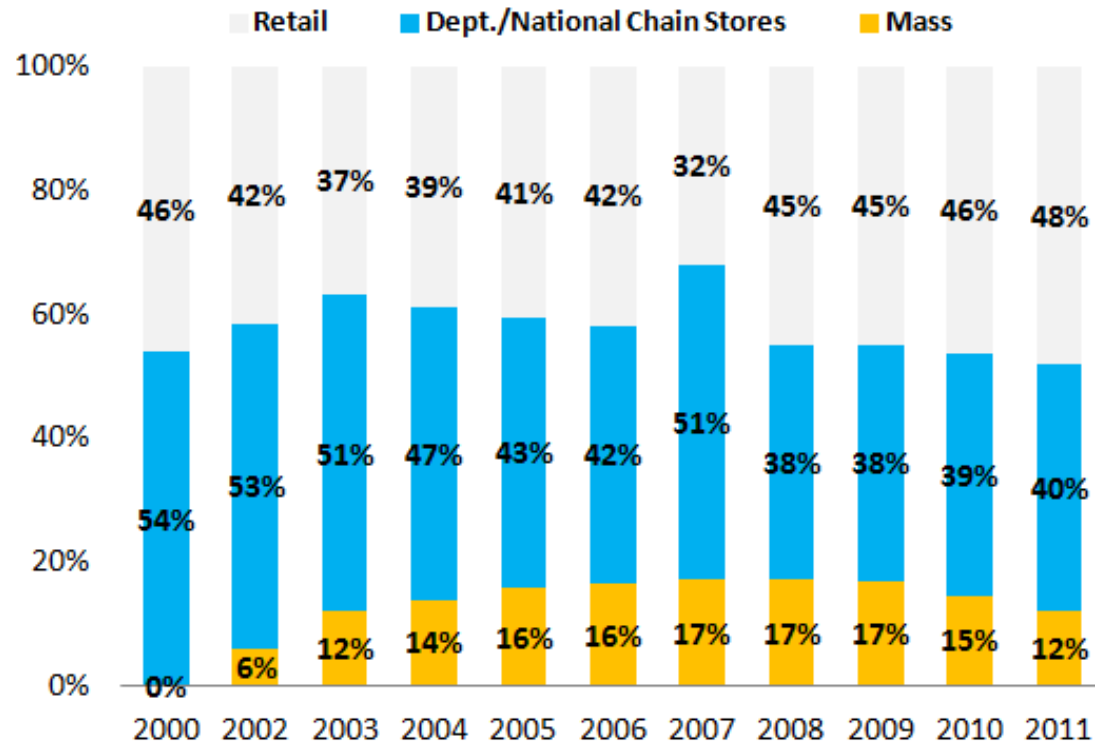


Source: Company Documents, NPD Group

Carter's will have to defend its share

Competitive Landscape Heating Up

Evolution of CRI's Channel Mix



Source: Company Documents & Hedgeye Ests

...and now things are heating up in the wholesale channel for the first time

Competitive Landscape Heating Up

Company Direct

Wholesale

Children's Place

Gymboree

Old Navy

Disney



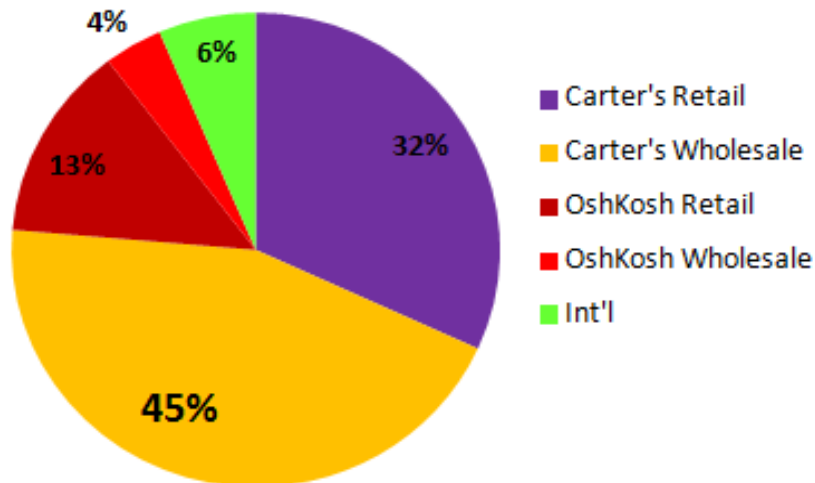
Carter's

Gerber

Direct Retailers are starting to test the waters...

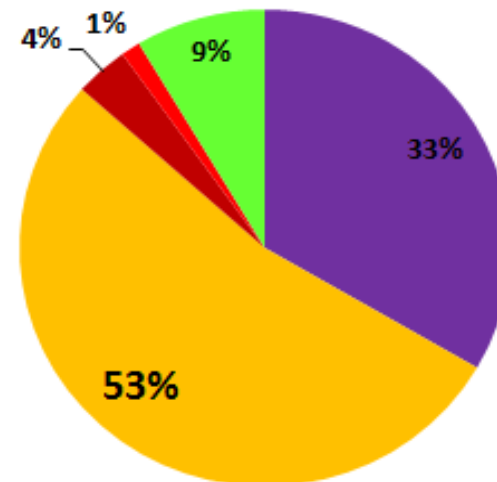
Competitive Landscape Heating Up

CRI: Revenues by Division



Source: Company Documents & Hedgeye Ests

EBIT Contribution by Division



The Penney Effect: wholesale account risk matters to the P&L

Demographic Inflection

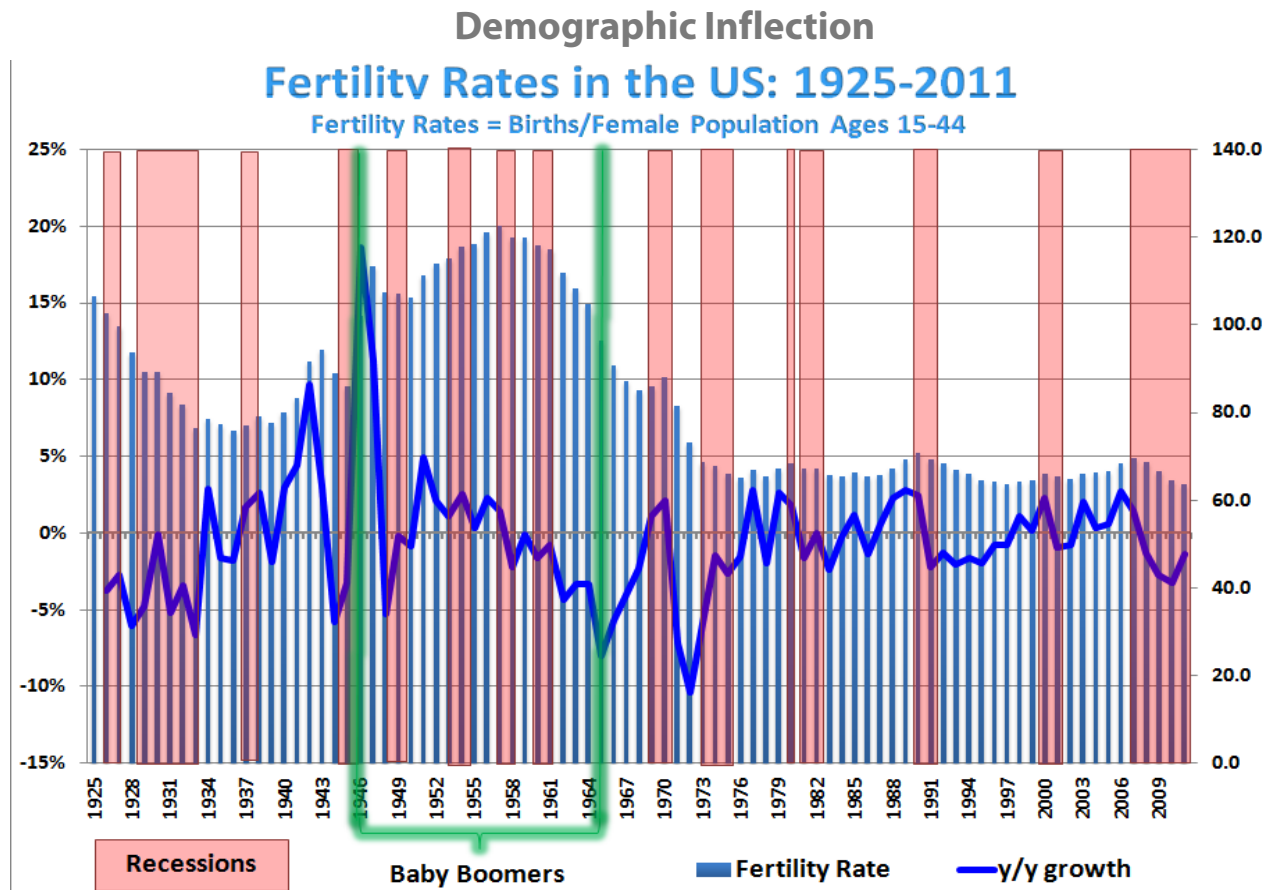


THE BIRTH RATE RECOVERY

(Research by Tom Tobin, Hedgeye Healthcare)

Demographic Inflection

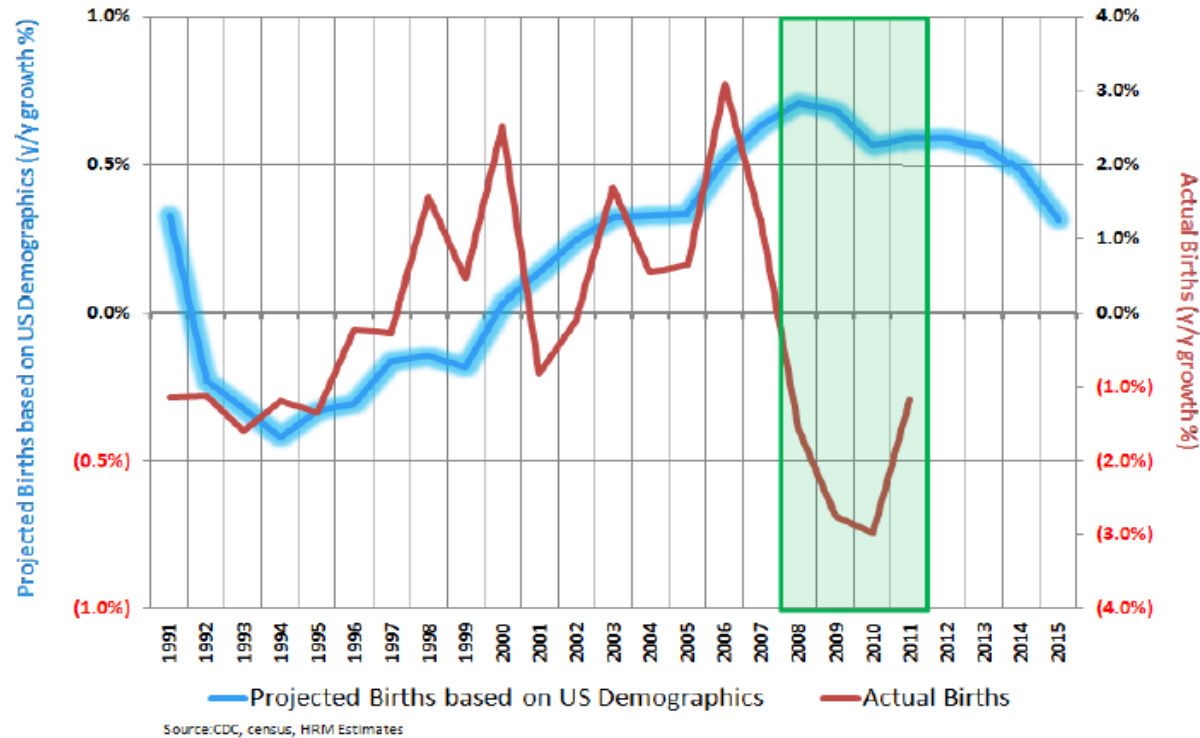
- **This is important re CRI for the following reasons:**
 - **Macro/demographics matter.**
 - **Birth trends are shifting from a 5-yr headwind to tailwind.**
 - **We've run the math quantifying the impact.**



Birth rates have reaccelerated after each of the last three recessions ending in '81, '92, and '02.

Demographic Inflection

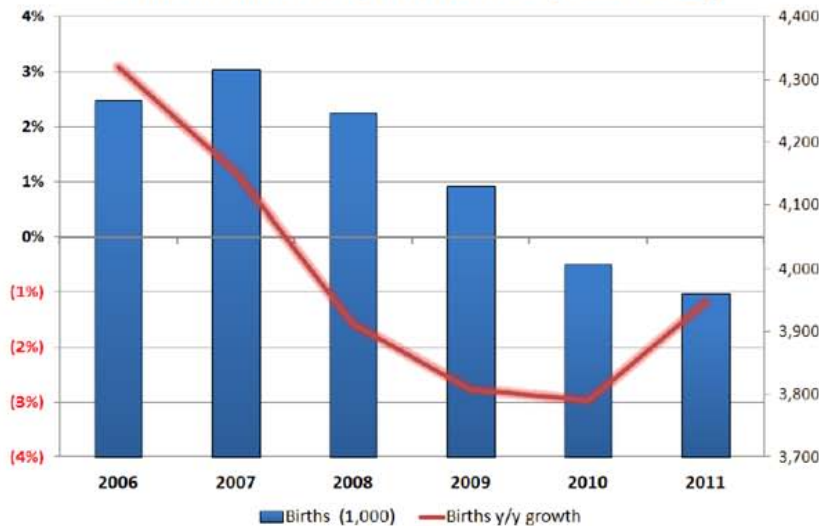
Projected US Births based on US Demographics
vs. Actual Births



The Great Recession halted the trend of what should have been an increase in births simply due to demographic projections based on demographics and fertility rates.

Demographic Inflection

US Birth Rates & Y/Y Growth % (2006-2011)

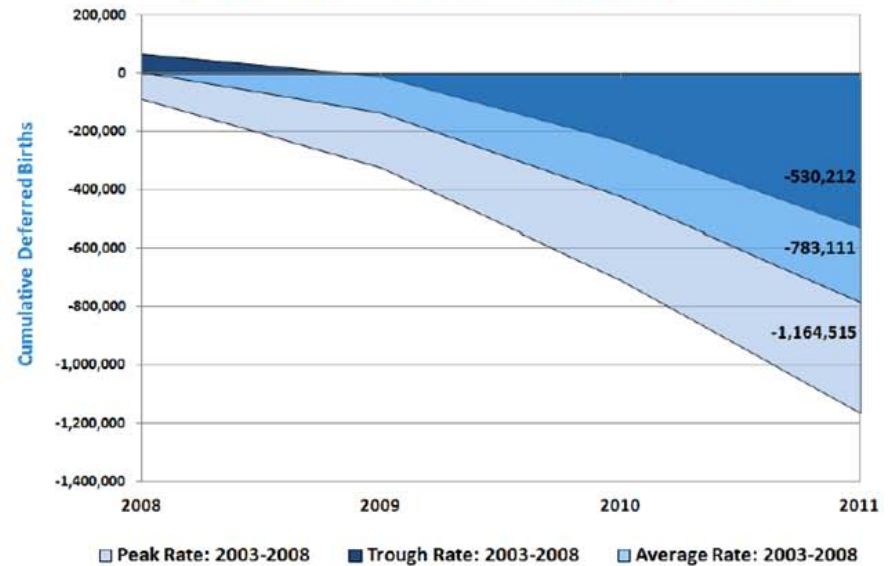


Source: CDC

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Source: CDC, census, HRM Estimates

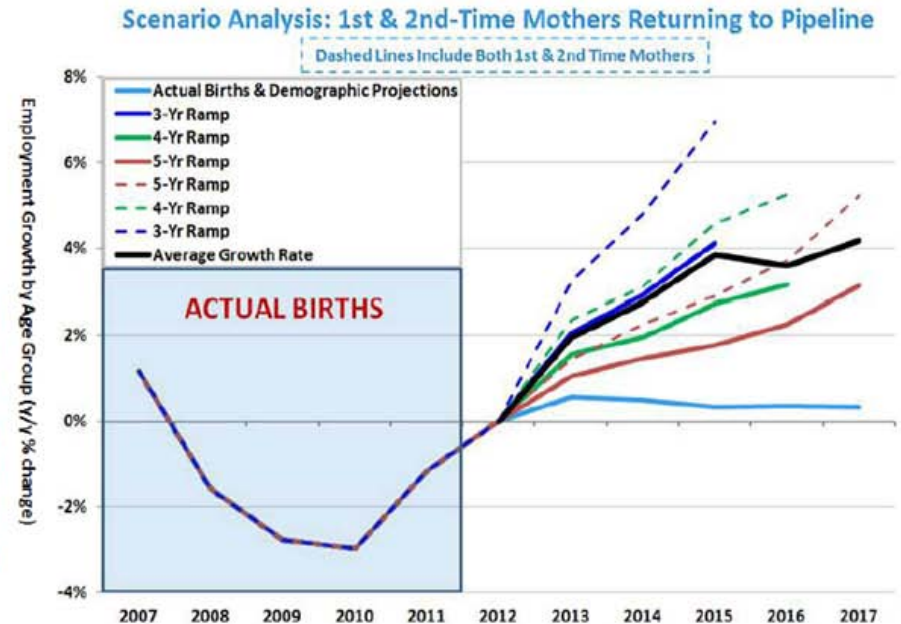
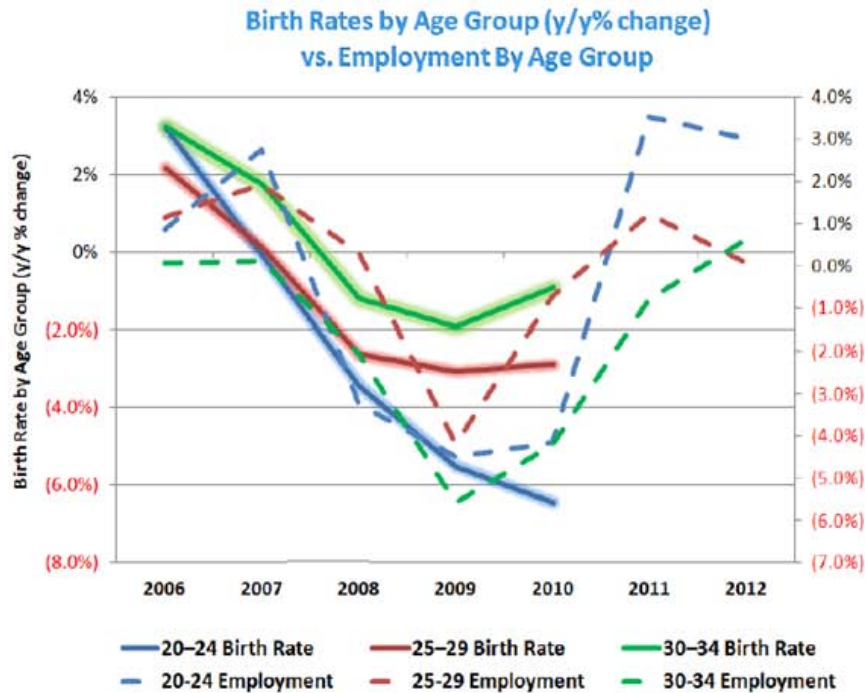
Deferred Births Scenario Analysis:
Peak, Trough, & Average Per-Capita Birth Rates (2003-2008)



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The decline in U.S. births over the last 5-years relative to the average per-capita birth rate and size of the female child-bearing population (15-44) from 2003-2008 resulted in an estimated 800,000 deferred births.

Demographic Inflection



Employment trends in the key child-bearing population (20-34) have improved over the last two years.

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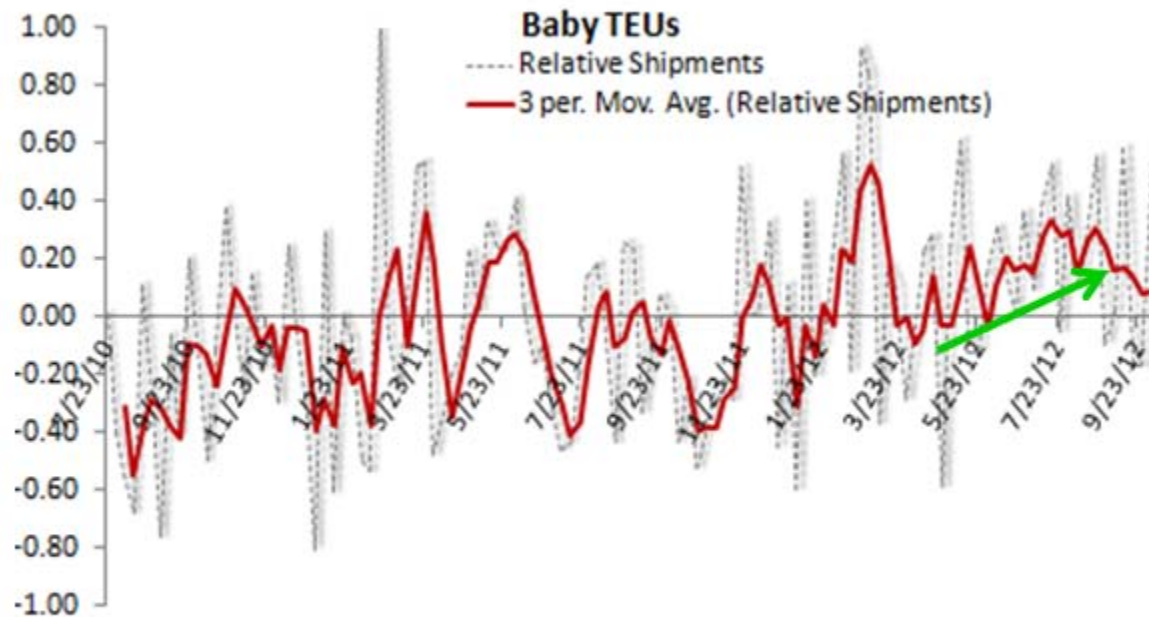
Demographic Inflection

		2013				2014				2015			
Birth Rate		2%	3%	4%	5%	2%	3%	4%	5%	2%	3%	4%	5%
Baby Apparel Market	3,000												
		3060	3090	3120	3150	3121	3183	3245	3308	3184	3278	3375	3473
Incr Revs to Market		60	90	120	150	61	93	125	158	62	95	130	165
CRI Share	24%	14.4	21.6	28.8	36.0	14.7	22.2	30.0	37.8	15.0	22.9	31.2	39.7
Rev Contribution to CRI		0.6%	0.9%	1.2%	1.5%	0.6%	0.9%	1.2%	1.5%	0.6%	0.9%	1.2%	1.5%
Kids Apparel Market	19,000												
										19380	19570	19760	19950
Incr Revs to Market										175	247	319	392
CRI Share	12%									21.0	29.6	38.3	47.0
Rev Contribution to CRI										0.8%	1.1%	1.4%	1.7%
Total Potential CRI Lift		0.6%	0.9%	1.2%	1.5%	0.6%	0.9%	1.2%	1.5%	1.3%	1.9%	2.6%	3.2%

Source: HE ests

This tailwind could equate to a 1-4pt tailwind for CRI

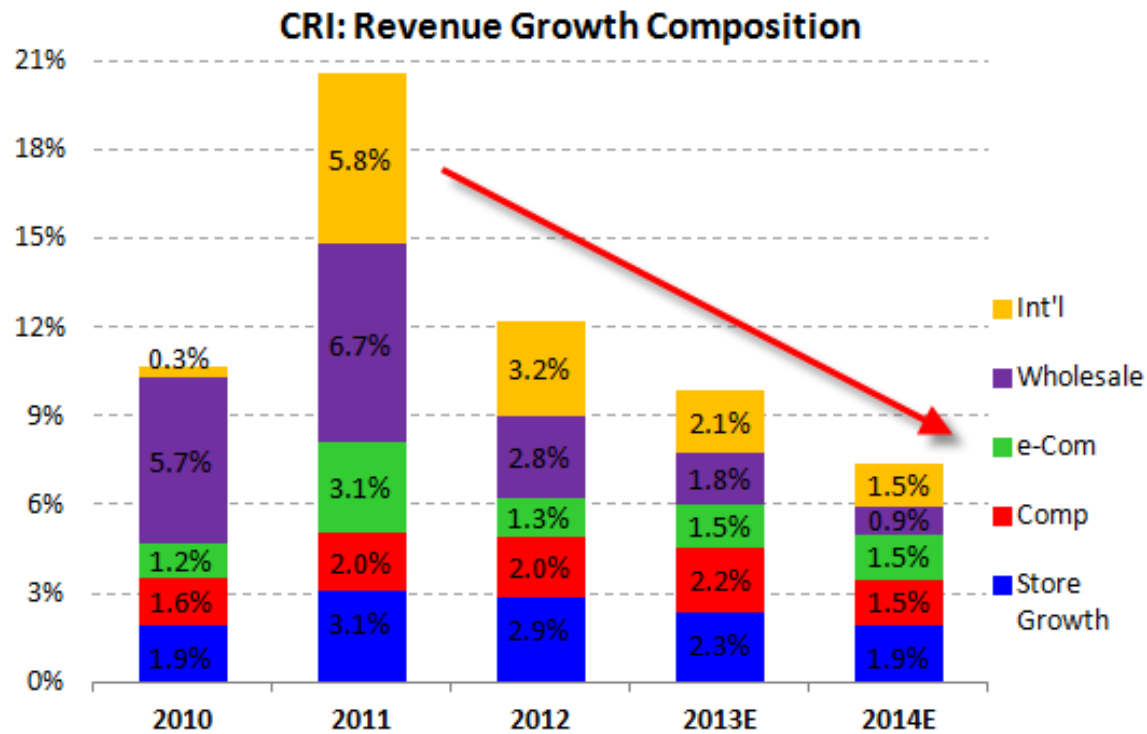
Demographic Inflection



Source: PIERS

Baby-related product entering this country is definitely on an uptrend

Margin Rebound Disconnect



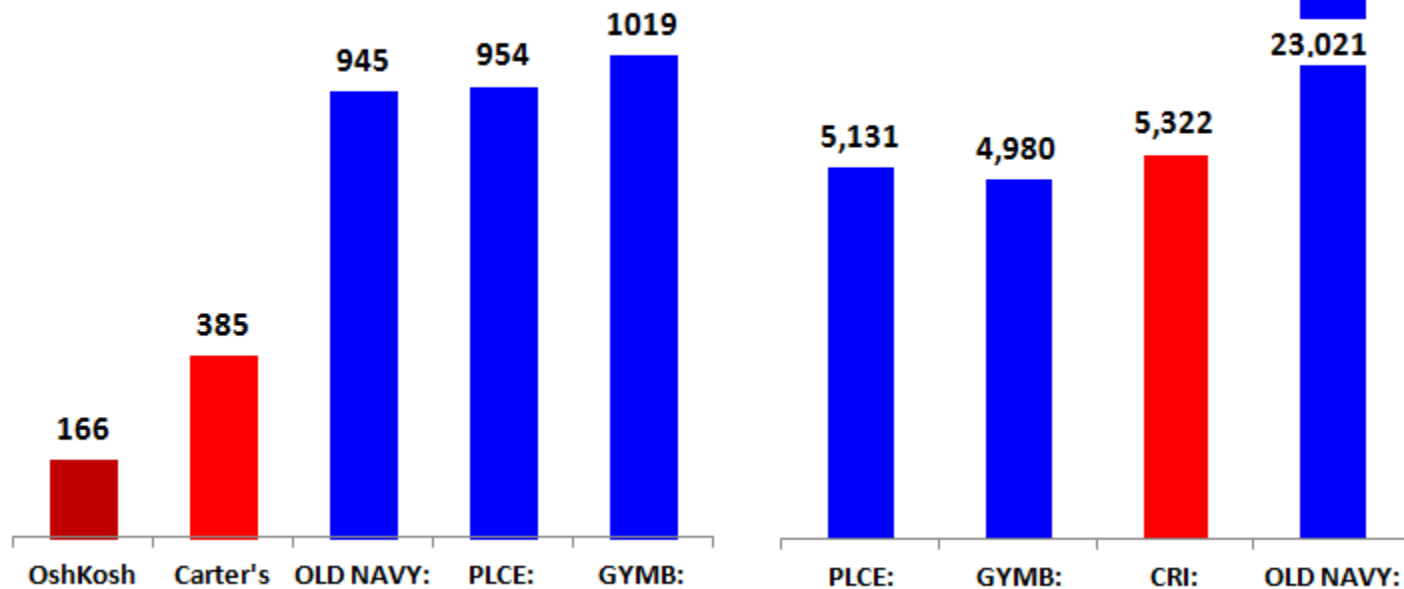
Source: Company documents & HE Ests

Spending will be going up to drive top-line growth

Margin Rebound Disconnect

Promising Retail Store Opportunity...

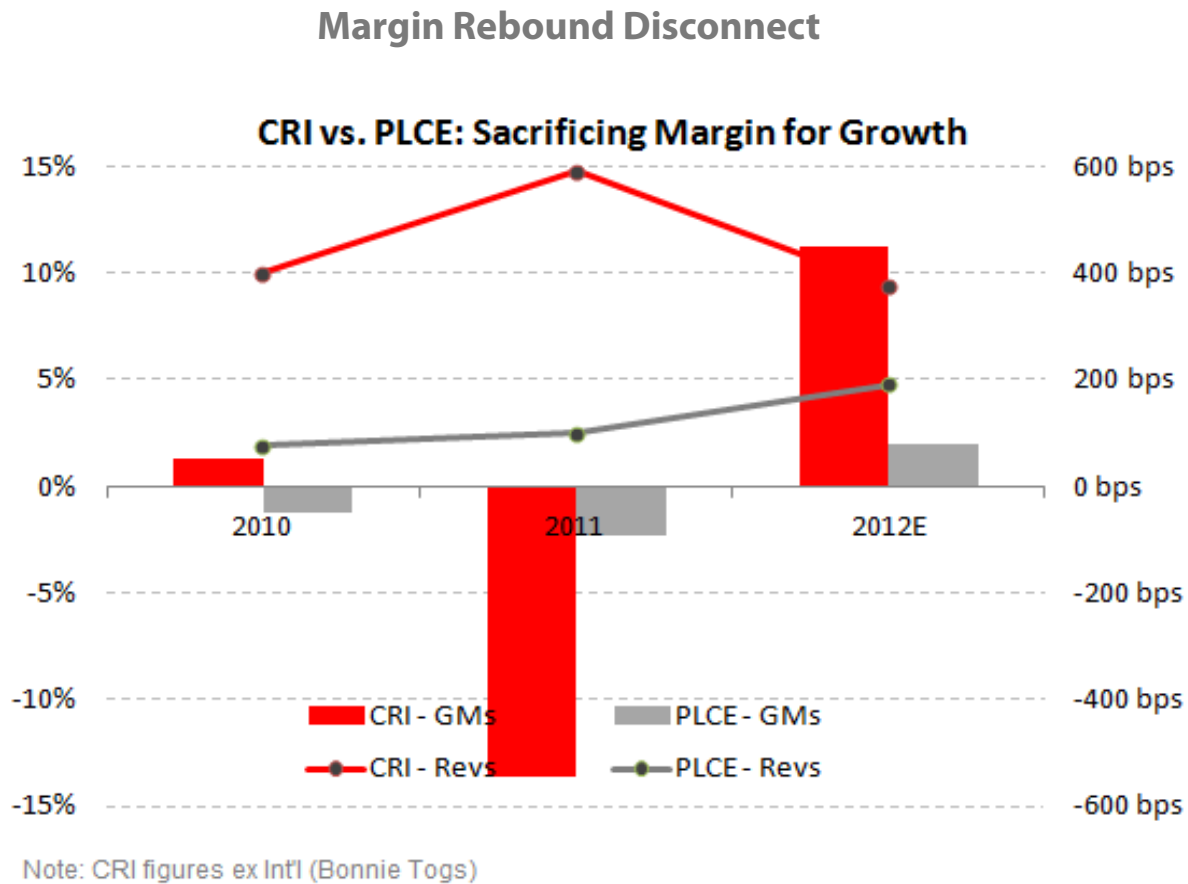
...But Let's Look at Square Footage



Source: Company Documents & Hedgeye Ests

Revenue runway may be a shorter than perceived

CRI: MARGIN REBOUND DISCONNECT



Management consciously sacrificed margin for sales and now expect price last Fall's +10% increase to hold through 2H and into Spring 2013.

Margin Rebound Disconnect

	Pre Cotton Escalation	Gross Margin Impact					
		2011E	Chg	2012E	Chg	2013E	Chg
Sales Price	\$6.00	\$6.60	10%	\$6.86	4%	\$6.59	-4%
Unit Cost	\$3.50	\$4.22	20%	\$4.22	0%	\$4.01	-5%
Unit Gross Profit	\$2.50	\$2.38	-10%	\$2.65	4%	\$2.58	1%
Gross Margin	41.7%	36.1%		38.6%		39.2%	
GM Impact		-555 bps		246 bps		64 bps	

	2013	2014	2015
% Direct	5%-15%	15%-25%	30%-40%

Manufacturing Cost Benefit ~45% of Product Cost	17 bps	34 bps	34 bps	69 bps	60 bps	120 bps
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Higher Margins	400 bps	800 bps	400 bps	800 bps	400 bps	800 bps
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There are many moving parts in Gross Margin

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Margin Rebound Disconnect

CRI - Mix Shift:							
	2009	2010	2011	2012E	2013E	2014E	2015E
<i>Sales Mix</i>							
Retail	46.4%	46.4%	45.1%	45.6%	46.9%	48.3%	49.1%
Whsl	51.2%	51.6%	48.4%	45.8%	43.3%	41.2%	39.5%
Int'l	1.8%	2.0%	6.5%	8.6%	9.8%	10.5%	11.4%
<i>Gross Margin</i>							
Retail	48.0%	48.0%	48.0%	48.0%	48.0%	48.0%	48.0%
Whsl	36.0%	36.0%	36.0%	36.0%	36.0%	36.0%	36.0%
Int'l	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%	55.0%
	41.7%	41.9%	42.6%	43.1%	43.5%	43.8%	44.1%
GM Impact		25 bps	70 bps	46 bps	39 bps	30 bps	26 bps

The least variable is the Retail/E-Commerce/Int'l shift mix tailwind

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Margin Rebound Disconnect

Gross Margin Analysis	2012		2013		2014		2015	
Cotton Pricing Shift	250 bps	350 bps	50 bps	250 bps	0 bps	0 bps	0 bps	0 bps
Manufacturing Cost Benefit	7 bps	10 bps	17 bps	34 bps	34 bps	69 bps	60 bps	120 bps
Retail/e-comm/Int'l Mix Shift	46 bps		39 bps		30 bps		26 bps	
Total Gross Margin Opportunity	300 bps	400 bps	100 bps	275 bps	65 bps	100 bps	90 bps	150 bps
HE Model Ests	350 bps		125 bps		100 bps		50 bps	
Consensus	450 bps		166 bps		125 bps			
Delta	-100 bps		-41 bps		-25 bps			

Expectations look lofty

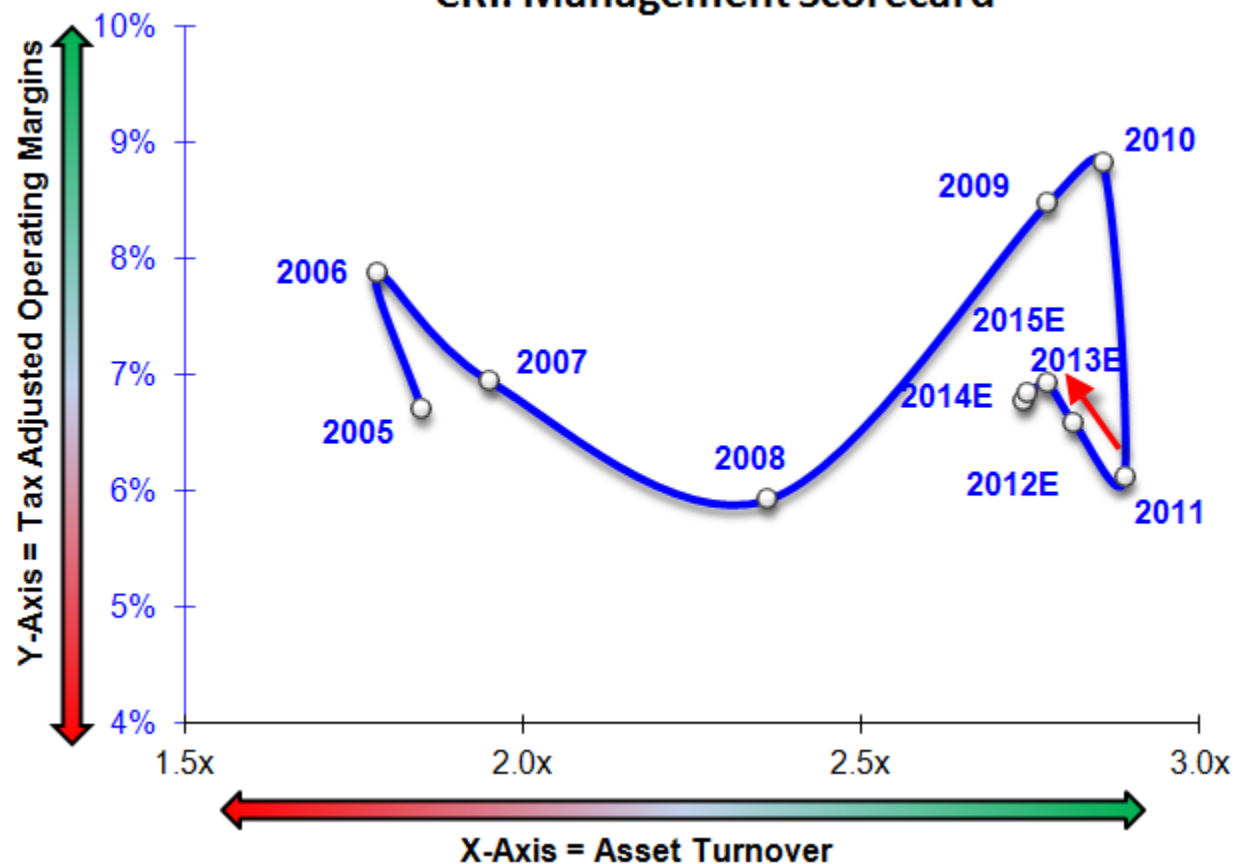
Asset Intensity Rising

- **Shifting from Harvesting to Investing...**
 - **Retail store growth**
 - **DC**
 - **Direct sourcing initiative**
 - **Marketing to defend share**
 - **Relocating/consolidating offices**

After 3yrs of harvesting, SG&A is not the line to look for margin leverage

Asset Intensity Rising

CRI: Management Scorecard



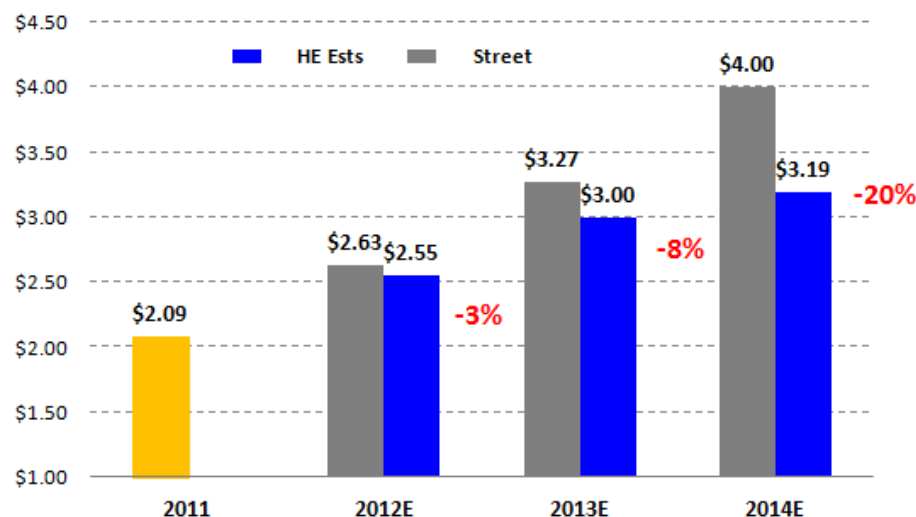
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Sentiment



So much for Berkshire buying...

Consensus Numbers are Too High



Source: Factset & Hedgeye Estimates

CRI:

	Street			HE				
	F12E	F13E	F14E	F12E	F13E	F14E		
Rev YoY	12.0%	9.9%	10.9%	12.2%	9.9%	7.4%		
EBIT%	10.9%	12.1%	13.4%	10.2%	10.7%	10.5%		
EPS	\$2.63	\$3.27	\$4.00	\$2.55	\$3.00	\$3.19		
EPS Grwth	26%	24%	22%	22%	18%	7%	Price	\$ 52.74
Avg NTM P/E	Implied Multiple		HE Multiple		Implied Downside			
High	15.5x	16.1x	14.5x		\$43.48	-18%		
Low	13.5x	16.1x	13.0x		\$38.99	-26%		

Source: Hedgeye Estimates

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Poor Product Differentiation

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Where's the product/pricing stratification?

Q&A

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For more information and a complete listing of research please
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or email: sales@hedgeye.com

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