# Coach, Inc. COH [XNYS] | ★★★

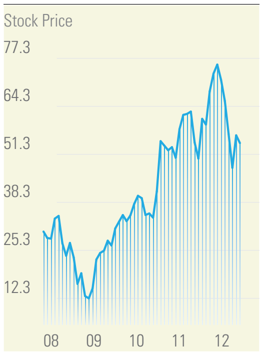
| Last Price | Fair Value | Consider Buy | Consider Sell | Uncertainty | Economic Moat™ | Stewardship | Morningstar Credit Rating | Industry |
|---|---|---|---|---|---|---|---|---|
| 53.71 USD | 63.00 USD | 37.80 USD | 97.65 USD | High | Narrow | Exemplary | | Luxury Goods |

## Coach has lower price points but higher operating margins than European luxury goods makers.

by Paul Swinand
Stock Analyst
Analyst covering this company do not own its stock.

Pricing as of Oct 12, 2012.
Rating as of Oct 12, 2012.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.




**Thesis** Apr. 27, 2012

With such historically strong financial metrics, investors may worry how sustainable Coach's record is. Fashion-driven companies can often seem like high-return companies when products and styles are popular, and fade quickly when tastes and preferences change. In our view, Coach has developed a narrow economic moat through a brand that commands pricing power, sourcing and distribution advantages, and attention on capital efficiency. We believe these competitive advantages are sustainable over our explicit forecast period, resulting in excess economic profits.

Even during the challenges of the recession, Coach's fundamentals were excellent, with three-year historical operating margins above 30% and returns on capital around 40%. Free cash flow generation has been also quite high, historically greater than 20% of revenue. Management's attention on capital efficiency and strong brand loyalty have been the key drivers of Coach's strong financial results. We judge brand to be more important than other softgoods categories--in bags and leather accessories, consumers tend to be more brand loyal, repurchasing the same brand of bag or matching the bag with accessories purchases. We liken this brand loyalty to be part fit, part style, and part product performance.

Coach has created sourcing and distribution advantages that contribute to our view of the sustainability of its competitive advantages. Recent hard work on sourcing due to cost pressures lengthens that advantage, in our view. Although some aspects such as quality control are process advantages that can be copied in the medium term, others, such as being one of the largest high-quality leather buyers on the planet, are more structural.

The current distribution footprint is still relatively small, and can be expanded without diluting the brand. Coach has more than 500 stores in the U.S., fewer than 200 stores in Japan, and should soon reach 100 stores in China. In the domestic market, roughly one third of the stores are factory outlets, which have a different customer mix and do a greater proportion of men's and tourist business. Coach has been improving its men's business domestically, and, although we believe it will always be smaller than women's, we believe there is some upside in this category. The men's business is also potentially bigger in China and Asia compared to western economies, as men in Asia give leather goods as gifts and tend to have more personal leather accessories compared to Coach's home markets; and we believe men's growth could show some upside from current trends.

Coach's international business is still underdeveloped and represents an opportunity if growth and margins continue on current trajectories. Many investors assume that Coach is too wed to the fortunes of the American consumer, but if the long-run success in Japan is taken as a guide, there is plenty of room for Coach to take share from European leather and accessories makers in other markets. In Japan, Coach has had flat to low single-digit growth rates for the past 10 years while other competitors generally have experienced declines. The company only just entered Europe last year through department store boutique partnerships. Again, many investors assume Coach will never compete with European bag makers, but it is our belief that there is room for new brands offering unique styles, makes, and price points. In China, Coach lags other luxury brands with respect to sales, but also has greater growth potential. The company doubled the business in 2010 to over $100 million and projects that by 2012 it will reach $300 million, and in 2014 it will attain $500 million in sales. Coach could also see higher operating margins in China as it expands due to lower operating costs. Similar estimates can be made for Europe, where Coach has just a small number of boutiques being tested in department stores. We estimate that the company could attain $500 million in sales in Europe over our forecast period.

Investors seem quick to punish Coach for any dip in margins or in average price points, pointing out that the brand is "aspirational" for consumers that can't afford the highest

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| Close Competitors | Currency (Mil) | Market Cap | TTM Sales | Oper Income | Net Income |
|---|---|---|---|---|---|
| **LVMH Moet Hennessy Louis Vuitton SA** | EUR | 61,306 | 26,333 | 5,514 | 3,436 |
| **Compagnie Financiere Richemont SA** | CHF | 32,706 | 12,271 | 2,823 | 2,137 |
| **Hermès International** | EUR | 22,909 | 2,841 | 885 | 594 |
| **Tiffany & Co.** | USD | 7,878 | 3,715 | 721 | 441 |
| **Vera Bradley, Inc.** | USD | 1,114 | 496 | 97 | 59 |

priced luxury brands. We agree that Coach products are aspirational, but also point out the resiliency of its operating results during the 2008-09 economic downturn. Coach did adjust price and product mix to represent more value to the consumer, which we think was a winning strategy despite the investor angst it created, and the sales rebound is proof that management did not dilute the brand. Coach has also showed more recently that it can raise average price points and deal with input costs fairly well. Our view is that the brand and distribution system that Coach has created is more bulletproof than a small change in price or mix would suggest, and we point to the still high margins and returns on capital, which we think will only improve during the next phases of recovery and expansion.

**Valuation, Growth and Profitability**

Our fair value estimate is $63 per share, based on the time value of money. Gross margins are now over 72%, given that cost pressures should subside as the calendar year continues, and currently we are modeling roughly 20 basis points of gross margin improvement, year over year, in fiscal 2013. Our updated fair value estimate implies 18 times fiscal 2012 earnings per share and 15 times fiscal 2013 earnings. On an enterprise value/EBITDA basis, our valuation implies 11 times fiscal 2012 and 9 times fiscal 2013. On a cash flow yield basis, our fair value suggests approximately 6% yield in fiscal 2013, in line with a five-year historical range of 4%-6%.

For fiscal 2012 (year ended June 2012), we project overall growth of nearly 16%, driven by high-single-digit comparable store sales growth in North America and around 14% square footage growth globally). We also anticipate gross margins holding an even performance, year over year, at 72.7% as the second half of 2012 improves. Some additional selling, general, and administrative spending will produce operating margins of 32.1% (compared with 31.4% in the fiscal year ended June 2011, and 32.2% expected for June 2013).

Over the next five years, we model annual average revenue growth around 12%. We expect net store openings to grow to 90 next year and to average 75 over the next five years, before fading to 45 at the end of our 10-year forecast period. We expect Coach to surpass $500 million in sales in China in 2014, faster than we previously expected, and 9% wholesale growth for five years based on European and new market development. Our five-year assumptions also include operating margins averaging over 32%. We project cash flows as a percentage of revenue to remain in the 20% range, dipping slightly below that in years five through 10, even with growth initiatives, dividends, and share buybacks.

**Risk**

Remaining fashionable and extending the brand are constant risks at Coach. If Coach extends the brand beyond what consumers understand it to be, the company could damage its core business. For example, Coach has produced some leather footwear and is also experimenting with some men's stores. Footwear does leverage some competitive advantages in leather sourcing, but in our opinion is an entirely different category than bags and accessories. Men's accessories have lower risk, in our opinion, but we cannot be sure that the extension will not dilute the women's business.

While Coach has established a niche in the fashion world, and customers are very brand-loyal in the handbag and accessories category, Coach runs the risk that changes in tastes and preferences will eventually lead to consumers turning elsewhere.

Coach also has been successful thus far extending the brand into new geographies, and a portion of our fair value is based on that continued expansion. Today, sales growth prospects appear strong, but there is a risk that new entrants or other market forces could derail the international projects that

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today look promising for Coach.

**Bulls Say**

- Coach's history, high-end positioning, and brand loyalty to its products give it the ability to price at levels above lesser brands but where consumers still see value. Its position is hard to copy and has led to high returns on capital.
- Coach's success abroad has only just begun, with growth and share gains to be had in China and other developing markets where the revenue base is small but growing. Coach has also just taken its first steps into Europe. The company's success in Japan proves it can compete effectively with European leather goods makers and gain share.
- With operating margins in the 30% range, Coach ranks as one of the best cash-generating consumer companies an investor can find.
- Coach continues to drive demand through its innovation in styles, colors, and materials. The company does extensive primary market research and picks attractive competitive spaces where it knows it can compete.
- Coach has been underestimated because it has focused efforts on the domestic market. New markets such as China and men's accessories in Asia offer unexplored opportunities.

**Bears Say**

- Since Coach's prices are lower, its customers tend to be more aspirational and thus more sensitive to the economy in general.
- Coach's growth strategy relies heavily on strong international markets, particularly Japan and China. Any change in demand or the inability to follow fashion trends there would affect Coach's earnings and future growth forecasts.
- Coach continues to extend into new product areas such as shoes and men's accessories. This could eventually dilute the core business or distract management attention.
- Coach appears to have incredible brand loyalty, but new entrants will eventually replace it as a midprice aspirational brand, as fashion brands don't last forever.
- Coach will always trail its European leather goods competitors, particularly in fast-growing Asian markets where consumers want only the number one brand and Coach has poor name recognition.

**Financial Overview**

Financial Health:With little debt on the balance sheet and its ability to turn roughly 20% of sales into free cash flow, Coach is in excellent financial health and well-positioned to fund growth. Coach has also increased its dividend to $0.90 per share and is in good shape to continue to raise dividends through existing and growing operating cash flows.

**Company Overview**

Profile: Coach is a manufacturer, distributor, and retailer focused on handbags and leather accessories in an assortment of styles. Its products offer the quality of higher luxury brands but at more attractive price points. Although about 60% of sales come from its more than 345 North American retail stores and more than 120 outlet stores, Coach also sells its products through department stores, international shops, the Internet, its catalog, and Coach stores in Japan and China. Coach recently opened European distribution through department stores.

Management: Lew Frankfort has served as chairman and CEO since 1995 and helped lead the firm through its initial public offering in October 2000. He has more than 25 years of experience at Coach. In recent years, he has revitalized the Coach brand and assembled a top-notch management team to lead this effort. In 2011, his total compensation was $12 million, down by $1 million, due to a lower stock grant and nonequity incentive compensation. Although Frankfort's compensation is generous, particularly in terms of equity compensation, we think his 1.7% stake in the company helps align his interests with those of other shareholders. President and executive creative director Reed Krakoff's total compensation of $21 million in 2011 does strike us as excessive despite his unquestionable contribution to the company's success. He owns less than 1% of the shares outstanding, and we would prefer to see him have a greater equity stake in the company.

A majority of Coach's board is independent, and officers and directors own nearly 5% of the shares outstanding. Although we would prefer to see the roles of chairman and CEO split, we like that the company has appointed a lead director who can challenge the CEO if necessary. We believe management does a good job of providing transparency around the business. Overall, corporate governance is good, in our opinion, and we rate Coach's stewardship of shareholder capital as exemplary given its long record of above average returns and recent actions to return cash to shareholders.

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## Analyst Notes

**Coach Earnings Solid, but Sales Miss Due to Weak Factory Store Comps Creates Buying Opportunity** Jul. 31, 2012

New York-based leather and accessories maker Coach COH reported fiscal fourth-quarter 2012 results that showed a solid rise in earnings per share of 27% to $0.86, a penny above the mean analysts' expectations. But sales increased only 12% to $1.16 billion, below the mean forecast of $1.20 billion, compared to an expected 16% rise. The sales slowdown was due to slower than anticipated comparable-store sales in the North American factory stores. Although management indicated that comparable-store sales slowdown was entirely due to the drop at the factory stores channel and that comps had picked up at the end of the quarter, investors selling the stock are clearly implying that these first signs of slowing in North America are consistent with additional weakening in the next year or two. In addition, Coach corroborates recent macroeconomic data points that suggest the domestic economy may be losing steam, presenting investors with additional worries. We think the current price of Coach stock of around $50 offers a significant discount to our $63 fair value estimate. New initiatives, including the men's business and the new Legacy line as well as ongoing gross margin improvement, should ensure stable cash flows and make strong returns on investment.

In the quarter, operating income increased 19% to $371 million, equaling a strong 32.1% of sales compared to 30.3% in the prior year. Sales were $1.16 billion, compared with $1.03 billion in the fiscal fourth quarter of 2011, a 12% increase that was below forecasts as North American comparable-store sales managed only a 1.7% increase. Offsetting the soft Western sales, sales in Japan increased 18%, although management expects most of the gain was due to the rebound after the earthquakes last year. China sales are still strong, up 60%, although the company only discloses comparable-store sales as "double digits." Management believes the fourth quarter's slow sales figure is entirely due to North American factory stores experiencing a decline in traffic, and also a more promotional environment as many consumers grew more cautious over the summer. While the specific sales results of factory and full-price stores are not explicitly disclosed, management did suggest the full-price stores were holding up, stating that they were experiencing increases in line with the 6%-7% increase of the prior quarter for all North American stores. Also in the quarter, gross margin improved to 72.6% from 71.8% last year, and selling, general, and administrative expenses leveraged 100 basis points to 40.5%, excluding a charitable contribution that exactly offsets a favorable tax settlement. Although management doesn't give explicit sales and earnings guidance, comments that fiscal 2013 would see investments in marketing and technology are clearly weighing on the stock. SG&A is expected to deleverage around 150 basis points on the year due to the ongoing acquisitions of Asian distributors, which increases the percentage of directly owned stores and raises gross margins, but requires investment in SG&A.

Looking ahead, we believe Coach is still an early phase of build-outs in Europe and Asia, and that square footage growth of 10% or more is sustainable over the next several years. Investments in Asia, especially China, should do well even if the economy continues to cool, and European distribution is only just beginning. We also believe that both the new Legacy line (which is really a platform for both men and women), the new men's business, and the potential to continue to expand gross margins bode well for the long-run cash flows of the company. Our fair value estimate, which might seem aggressive implying 18 times trailing twelve month earnings in a slowing economy, implies just 14 times

## Analyst Notes (continued)

forward earnings, a cash flow yield above 5% in 2013 and above 6% in 2014. With nearly $1 billion in cash, the stock also looks cheap on an enterprise value/EBITDA basis, at just over 7 times forward EV/EBITDA. Finally, we also point out that with the share price being so low and the firm's large amount of cash, significant share buybacks could accelerate.

**Coach Delivers Solid Growth and Earnings Leverage: Couponing Strategy Withdrawal Suggests Strength**

Apr. 26, 2012

Coach COH  announced fiscal third-quarter earnings for the period ended in March. Results were mildly above both our own and market expectations, with sales rising 17% to $1.1 billion, and earnings per share rising to $0.77, or 24%. North American same-store sales rose 6.7%, representing the fifth consecutive decline since fiscal second quarter 2011, when the company produced a same-store sales increase of 12.6%. By comparison in the last quarter, North American same-store sales were up 8.8%, but management believes its decision to eliminate coupons was a reason for the softer sequential comparable-store sales in this quarter versus the trailing quarters. The decision to reduce promotions contributed to strong gross margins that advanced a strong 100 basis points to 73.8%.

While Coach still trades above our $60 fair value estimate, we are actually encouraged by the coupon elimination strategy. Coupons and similar promotions are most effective when targeted at price-sensitive customers, and also historically have been used to build both customer trial and store traffic in most marketing campaigns. We believe this is a signal that the more aspirational customer may be returning to outlets and increasing purchases, without the offer of a discount. Longer term, discounts can damage the brand, and we also believe this is a sign that inventory is in decent shape (up 21%, including the absorption of a distributor and 10% store growth).

We underline that Coach is the highest-operating margin stock we cover (we're projecting more than 32% for the next two years), and also one of the highest returns on capital businesses in our coverage. Thus is it little surprise the company is buying back shares to produce about 2% leverage on earnings per share, and increasing its dividend to an annual $1.20. Given the quality of the company and the universal strength in luxury, Coach shares are trading at a premium to our $60 fair value estimate, which will move up at the cost of capital. At a current price of 20 times fiscal year 2012 earnings (period ending June), and 17 times fiscal 2013 earnings, this stock is not terribly expensive given its double-digit growth trajectory and attention to stock buybacks, both of which contribute to earnings growth in the 20% plus range. And while we also like the potential growth trajectory in Europe and China, we'd also point out that some of the European luxury names, such as LVMH MC, have become relatively cheaper because of Europe macro worries. By comparison, LVMH is trading within just a few percentage points of our fair value estimate, and trades at a price earnings of 17 times December 2012 earnings.

Recent store visits we've made at Coach suggest strong traffic at both full-price stores and outlets, and we also believe Coach benefits more from "average" travelers and less from "ultra luxury" Chinese travelers. This trait should make it more resilient in the scenario of a China slowdown, in addition to the value position of its brand and its relatively smaller and younger store base in China. New product launches scheduled for this summer, including a "dual gender" collection called "Legacy," and 58 additional men's collection full-price store presentations are also brand builders and should drive positive comparable-store sales, in our opinion. On the gross margin side, we believe our

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## Analyst Notes (continued)

projection of mild leverage from sourcing initiatives and hard work reducing taxes and duties on materials and shipments could prove conservative, and could also continue to play out over a number of years. Coach's relatively high operating margin of more than 32% has run as high as 38% and 36% in the fiscal years ended June 2007 and June 2008, when gross margins were around 77%. While SG&A has been controlled and is near historical lows, we believe gross margins gains can still be had longer term. We also believe the hard work on margins should positively influence competitive advantages in sourcing and quality control, which we view as equally important to Coach's narrow-moat rating as fashion and brand experience. The latter two are necessities; but other brands can do the same. Sourcing and quality are inherently harder to do, and recent volatility in labor and commodity costs have, in our opinion, increased the complexity and defendability of the sourcing process.

# Coach, Inc. COH

| Sales USD Mil | Mkt Cap USD Mil | Industry | Sector |
|---|---|---|---|
| 4,763 | 15,452 | Luxury Goods | Consumer Cyclical |

| Morningstar Rating | Last Price | Fair Value | Uncertainty | Economic Moat™ | Stewardship |
|---|---|---|---|---|---|
| — | 54.43 | — | — | — | — |

per share prices in USD

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New York, NY 10001
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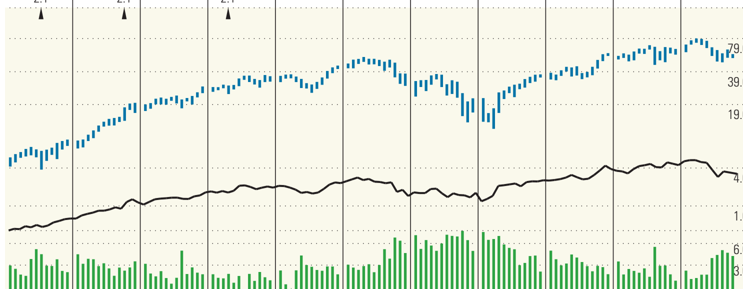
| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Annual Price High | 8.93 | 20.27 | 28.85 | 36.84 | 44.99 | 54.00 | 37.64 | 37.36 | 58.55 | 69.20 | 79.70 |
| Low | 4.33 | 7.26 | 16.95 | 24.51 | 25.18 | 29.22 | 13.19 | 11.41 | 32.96 | 45.70 | 48.24 |
| Recent Splits | 2:1 | 2:1 | | 2:1 | | | | | | | |




**Price Volatility**
Monthly High/Low
Rel Strength to S&P 500

52 week High/Low
79.70 - 48.24

10 Year High/Low
79.70 - 4.33

Bear-Market Rank
4 (10=worst)

Trading Volume Million

| Stock Performance | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | YTD |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Return % | 68.9 | 129.9 | 49.0 | 18.2 | 28.9 | -28.8 | -32.1 | 77.0 | 52.9 | 11.9 | -9.5 |
| +/- Market | 92.3 | 103.5 | 40.0 | 15.2 | 15.3 | -32.3 | 6.4 | 53.6 | 40.1 | 11.9 | -23.4 |
| +/- Industry | 77.6 | 39.9 | 35.2 | 11.6 | 5.5 | -5.8 | 14.4 | -10.7 | -0.4 | 0.4 | -22.2 |
| Dividend Yield % | — | — | — | — | — | — | — | 0.6 | 0.9 | 1.4 | 1.9 |
| Market Cap USD Mil | 2921 | 7024 | 10655 | 12671 | 15787 | 11258 | 6790 | 11470 | 16393 | 17813 | 15452 |

## Growth Rates Compound Annual

| Grade: B | 1 Yr | 3 Yr | 5 Yr | 10 Yr |
|---|---|---|---|---|
| Revenue % | 14.5 | 13.8 | 12.8 | 20.8 |
| Operating Income % | 15.9 | 15.9 | 8.8 | 27.5 |
| Earnings/Share % | 20.9 | 22.7 | 15.9 | 31.1 |
| Dividends % | 44.4 | 135.1 | — | — |
| Book Value/Share % | 25.1 | 9.4 | 6.4 | 25.3 |
| Stock Total Return % | -6.4 | 18.0 | 5.1 | 24.7 |
| +/- Industry | -23.8 | -8.0 | -2.1 | 8.9 |
| +/- Market | -26.3 | 7.8 | 6.8 | 20.5 |

## Profitability Analysis

| Grade: A | Current | 5 Yr Avg | Ind | Mkt |
|---|---|---|---|---|
| Return on Equity % | 57.6 | 48.9 | 21.0 | 22.8 |
| Return on Assets % | 36.2 | 31.8 | 10.6 | 9.3 |
| Fixed Asset Turns | 7.8 | 7.0 | 6.8 | 7.7 |
| Inventory Turns | 2.8 | 2.7 | 1.7 | 17.0 |
| Revenue/Employee USD K | 264.6 | 273.1 * | — | 1055.7 |
| Gross Margin % | 72.8 | 73.2 | 59.5 | 39.7 |
| Operating Margin % | 31.7 | 32.2 | 10.3 | 16.6 |
| Net Margin % | 21.8 | 21.5 | 10.4 | 11.1 |
| Free Cash Flow/Rev % | 21.8 | 21.9 | 6.3 | 0.1 |
| R&D/Rev % | — | — | — | 9.5 |

## Financial Position

| Grade: A | 06-11 USD Mil | 06-12 USD Mil |
|---|---|---|
| Cash | 700 | 917 |
| Inventories | 422 | 504 |
| Receivables | 143 | 174 |
| Current Assets | 1452 | 1805 |
| Fixed Assets | 582 | 644 |
| Intangibles | 341 | 386 |
| Total Assets | 2635 | 3104 |
| Payables | 184 | 241 |
| Short-Term Debt | 1 | 22 |
| Current Liabilities | 593 | 718 |
| Long-Term Debt | 23 | 1 |
| Total Liabilities | 1023 | 1111 |
| Total Equity | 1613 | 1993 |

## Valuation Analysis

| | Current | 5 Yr Avg | Ind | Mkt |
|---|---|---|---|---|
| Price/Earnings | 15.4 | 16.6 | 18.6 | — |
| Forward P/E | 12.2 | — | — | 13.2 |
| Price/Cash Flow | 13.1 | 13.1 | 16.7 | — |
| Price/Free Cash Flow | 15.4 | 15.8 | 30.7 | — |
| Dividend Yield % | 1.9 | — | 1.3 | 2.0 |
| Price/Book | 7.8 | 7.4 | 4.5 | — |
| Price/Sales | 3.4 | 3.6 | 2.0 | — |
| PEG Ratio | 0.8 | — | — | 0.3 |

| Financials | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenue USD Mil | 953 | 1321 | 1710 | 2112 | 2612 | 3181 | 3230 | 3608 | 4159 | 4763 | 4763 |
| Gross Margin % | 71.1 | 74.9 | 76.6 | 77.6 | 77.4 | 75.7 | 71.9 | 73.0 | 72.7 | 72.8 | 72.8 |
| Oper Income USD Mil | 244 | 444 | 622 | 765 | 993 | 1147 | 972 | 1150 | 1305 | 1512 | 1512 |
| Operating Margin % | 25.6 | 33.6 | 36.4 | 36.2 | 38.0 | 36.1 | 30.1 | 31.9 | 31.4 | 31.7 | 31.7 |
| Net Income USD Mil | 147 | 262 | 389 | 494 | 664 | 783 | 623 | 735 | 881 | 1039 | 1039 |
| Earnings Per Share USD | 0.40 | 0.68 | 1.00 | 1.27 | 1.76 | 2.17 | 1.91 | 2.33 | 2.92 | 3.53 | 3.53 |
| Dividends USD | — | — | — | — | — | — | 0.08 | 0.38 | 0.68 | 0.98 | 0.98 |
| Shares Mil | 372 | 386 | 390 | 388 | 377 | 360 | 326 | 316 | 302 | 294 | 294 |
| Book Value Per Share USD | 1.18 | 2.08 | 2.74 | 3.09 | 5.15 | 4.37 | 5.33 | 4.93 | 5.49 | 6.94 | 7.02 |
| Oper Cash Flow USD Mil | 222 | 449 | 544 | 597 | 779 | 923 | 809 | 991 | 1033 | 1222 | 1222 |
| Cap Spending USD Mil | -57 | -68 | -95 | -134 | -141 | -175 | -240 | -81 | -148 | -184 | -184 |
| Free Cash Flow USD Mil | 165 | 381 | 450 | 463 | 638 | 749 | 569 | 910 | 886 | 1037 | 1037 |

| Profitability | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets % | 27.7 | 31.8 | 32.7 | 33.2 | 32.6 | 33.2 | 25.8 | 29.2 | 34.5 | 36.2 | 36.2 |
| Return on Equity % | 42.7 | 43.3 | 42.8 | 44.5 | 42.8 | 45.7 | 38.8 | 45.9 | 56.5 | 57.6 | 57.6 |
| Net Margin % | 15.4 | 19.8 | 22.7 | 23.4 | 25.4 | 24.6 | 19.3 | 20.4 | 21.2 | 21.8 | 21.8 |
| Asset Turnover | 1.80 | 1.60 | 1.44 | 1.42 | 1.28 | 1.35 | 1.34 | 1.43 | 1.63 | 1.66 | 1.66 |
| Financial Leverage | 1.5 | 1.3 | 1.3 | 1.4 | 1.3 | 1.5 | 1.5 | 1.6 | 1.6 | 1.6 | 1.6 |

| Financial Health | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 06-12 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Working Capital USD Mil | 287 | 524 | 444 | 633 | 1332 | 935 | 937 | 774 | 859 | 1086 | 1086 |
| Long-Term Debt USD Mil | 4 | 3 | 3 | 3 | 3 | 3 | 25 | 24 | 23 | 1 | 1 |
| Total Equity USD Mil | 427 | 782 | 1033 | 1189 | 1910 | 1516 | 1696 | 1505 | 1613 | 1993 | 1993 |
| Debt/Equity | 0.01 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.01 | 0.02 | 0.01 | 0.00 | 0.01 |

| Valuation | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | TTM |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Price/Earnings | 26.6 | 36.0 | 33.7 | 27.8 | 28.3 | 16.1 | 9.5 | 18.3 | 20.1 | 19.1 | 15.4 |
| P/E vs. Market | — | — | — | — | — | — | — | — | — | 1.1 | — |
| Price/Sales | 3.6 | 6.4 | 7.2 | 6.7 | 6.9 | 3.9 | 2.2 | 3.5 | 4.3 | 4.1 | 3.4 |
| Price/Book | 8.7 | 11.9 | 10.8 | 9.3 | 10.7 | 7.1 | 4.6 | 6.2 | 9.4 | 9.5 | 7.8 |
| Price/Cash Flow | 19.8 | 24.1 | 20.4 | 21.5 | 23.0 | 13.3 | 9.5 | 10.9 | 17.4 | 14.3 | 13.1 |

## Quarterly Results

| Revenue USD Mil | Sep 11 | Dec 11 | Mar 12 | Jun 12 |
|---|---|---|---|---|
| Most Recent Period | 1050.4 | 1448.7 | 1109.0 | 1155.2 |
| Prior Year Period | 911.7 | 1264.5 | 950.7 | 1031.7 |
| **Rev Growth** % | Sep 11 | Dec 11 | Mar 12 | Jun 12 |
| Most Recent Period | 15.2 | 14.6 | 16.6 | 12.0 |
| Prior Year Period | 19.7 | 18.7 | 14.4 | 8.5 |
| **Earnings Per Share** USD | Sep 11 | Dec 11 | Mar 12 | Jun 12 |
| Most Recent Period | 0.73 | 1.18 | 0.77 | 0.86 |
| Prior Year Period | 0.63 | 1.00 | 0.62 | 0.68 |

## Industry Peers by Market Cap

| | Mkt Cap USD Mil | Rev USD Mil | P/E | ROE% |
|---|---|---|---|---|
| Coach, Inc. | 15452 | 4763 | 15.4 | 57.6 |
| LVMH Moet Hennessy L | — | 79390 | 13.2 | 7.4 |
| Compagnie Financiere | 3519 | 883 | 15.4 | 10.1 |

## Major Fund Holders

| | % of shares |
|---|---|
| | — |
| | — |
| | — |

*3Yr Avg data is displayed in place of 5Yr Avg

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

## Morningstar's Approach to Rating Stocks

**Our Key Investing Concepts**

- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

### Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such

**Morningstar Research Methodology for Valuing Companies**

Competitive Analysis → **Economic Moat™ Rating** → Company Valuation → **Fair Value Estimate** → Uncertainty Assessment → ★★★★★

| Competitive Analysis | Economic Moat™ Rating | Company Valuation | Fair Value Estimate | Uncertainty Assessment | ★★★★★ |
|---|---|---|---|---|---|
| Analyst conducts company and industry research:<br>• Management interviews<br>• Conference calls<br>• Trade-show visits<br>• Competitor, supplier, distributor, and customer interviews | The depth of the firm's competitive advantage is rated:<br>• None<br>• Narrow<br>• Wide | Analyst considers company financial statements and competitive position to forecast future cash flows.<br><br>Assumptions are input into a discounted cash-flow model. | DCF model leads to the firm's Fair Value Estimate, which anchors the rating framework. | An uncertainty assessment establishes the margin of safety required for the stock rating. | ★<br>★★<br>★★★<br>★★★★<br>★★★★★<br>The current stock price relative to fair value, adjusted for uncertainty, determines the rating. |

economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

**Discounted Cash Flow**
This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

**Discount Rate**
We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

**Fair Value**
This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

**Uncertainty**
To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

**Margin of Safety**
This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

**Consider Buying/Consider Selling**
The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

**Stewardship Grades**
Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.