

Fossil Group, Inc

Old name still on KORS

BUY, USD 135

26 April 2014

Overview

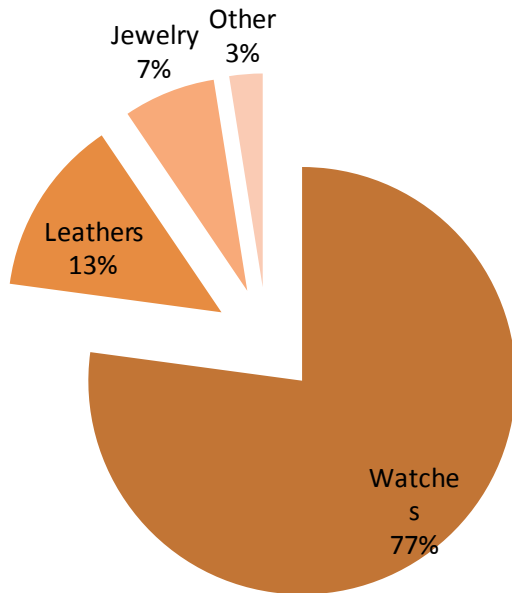
Fossil Group Inc (NASDAQ: FOSL)

Rating	BUY
Last close (24 Apr)	108.28
TP (1-yr)	135
Upside (1-yr)	23.50%
Mkt cap	5.825bn
3-month avg value	107.6m
P/E (TTM)	16.5x
P/B	5.6x
ROE	35.20%
EV/EBITDA	10.5
5Y sales growth	15.50%
52-week low/high	92.44 / 134.99
Shares outstanding	53.8m
Free float	44.1m
Insti. hldgs	93.72%

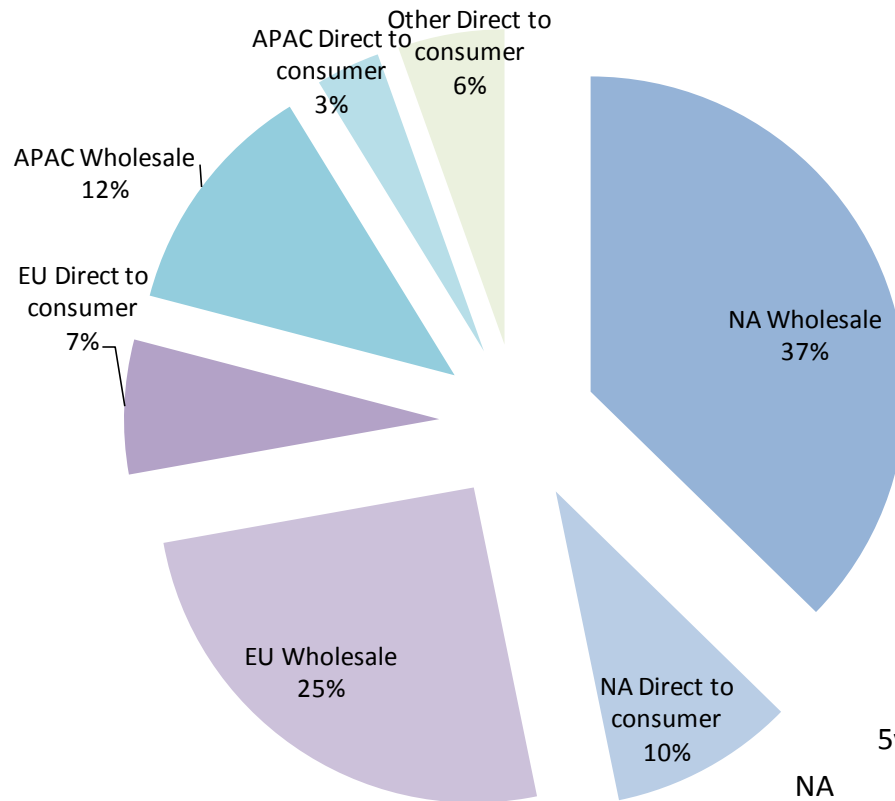
- Unique niche: exclusive worldwide licensor for fashion brands' watches and jewelry
- Exposure to consumer darling KORS and broader luxury sector
- Luxury growth > GDP growth on economic and social trends
- Excellent execution: 30,000 points of sale worldwide, talented in-house designers
- Catalysts: Android Wear, Tory Burch

What does FOSL do?

FOSL designs, manufactures and sells consumer fashion accessories...



Internationally through wholesale and direct to consumer channels

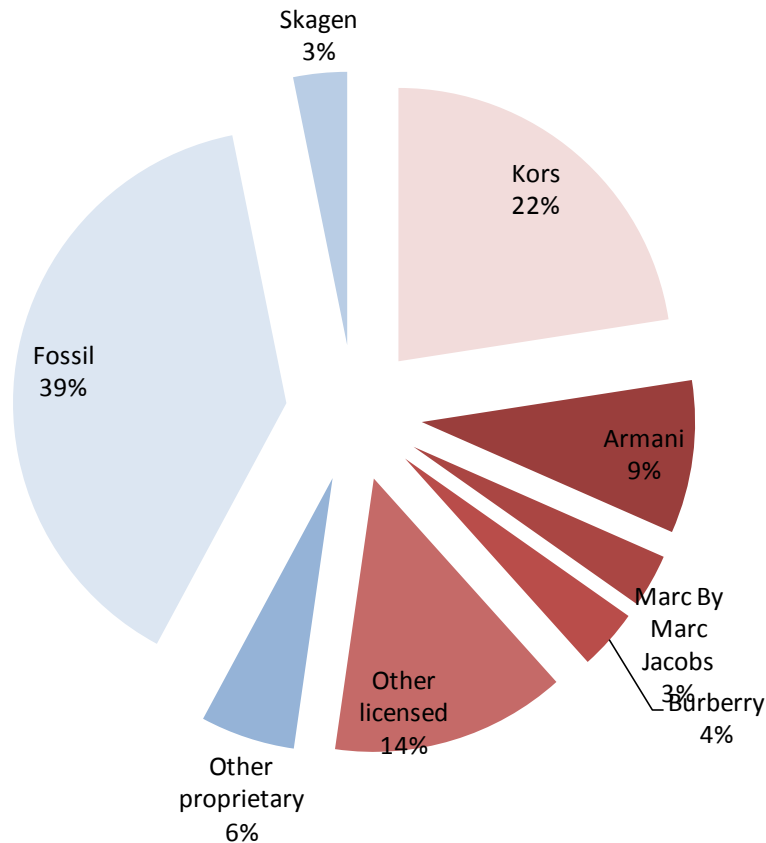


5yr sales CAGR

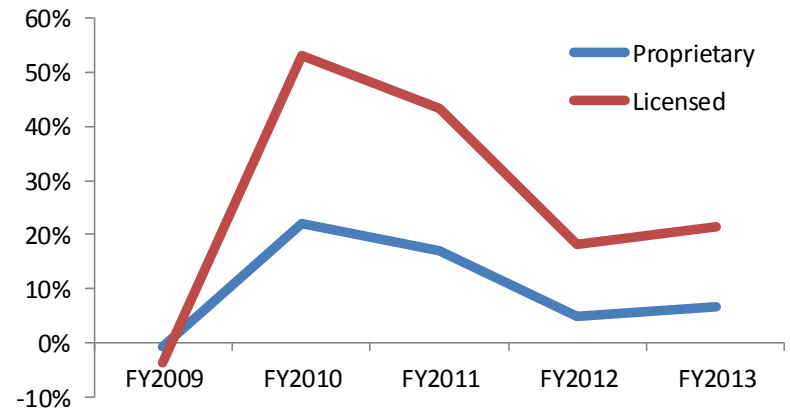
NA	15.0%
EU	13.3%
APAC	22.4%

Which are FOSL's brands?

Brands by FY13 revenue



Faster growth from licensed products

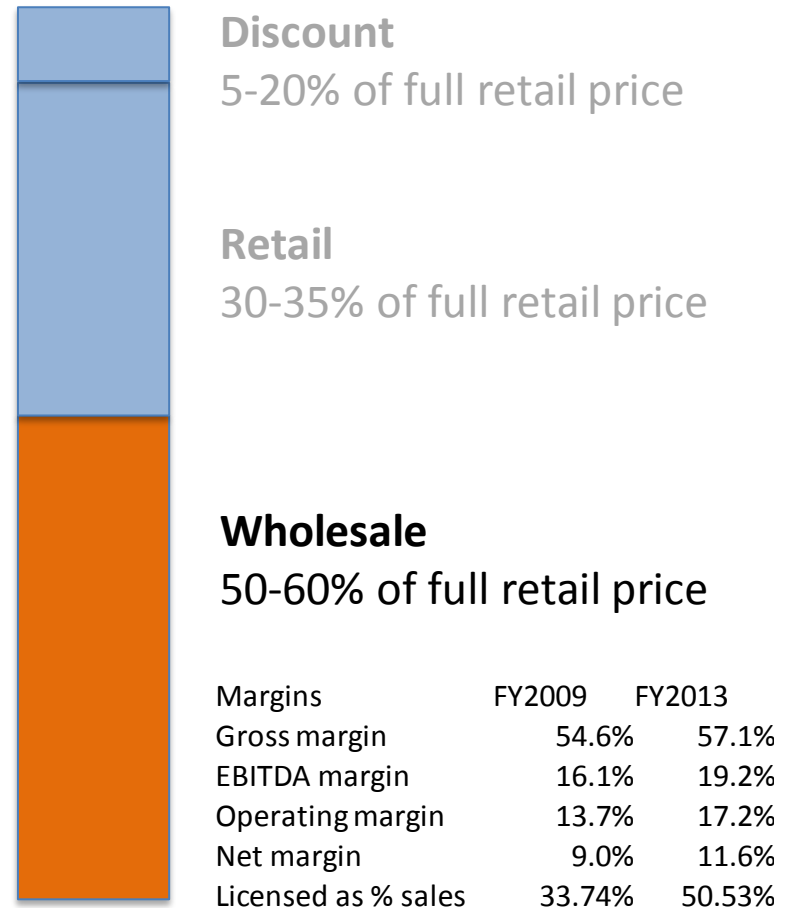


Brands split among

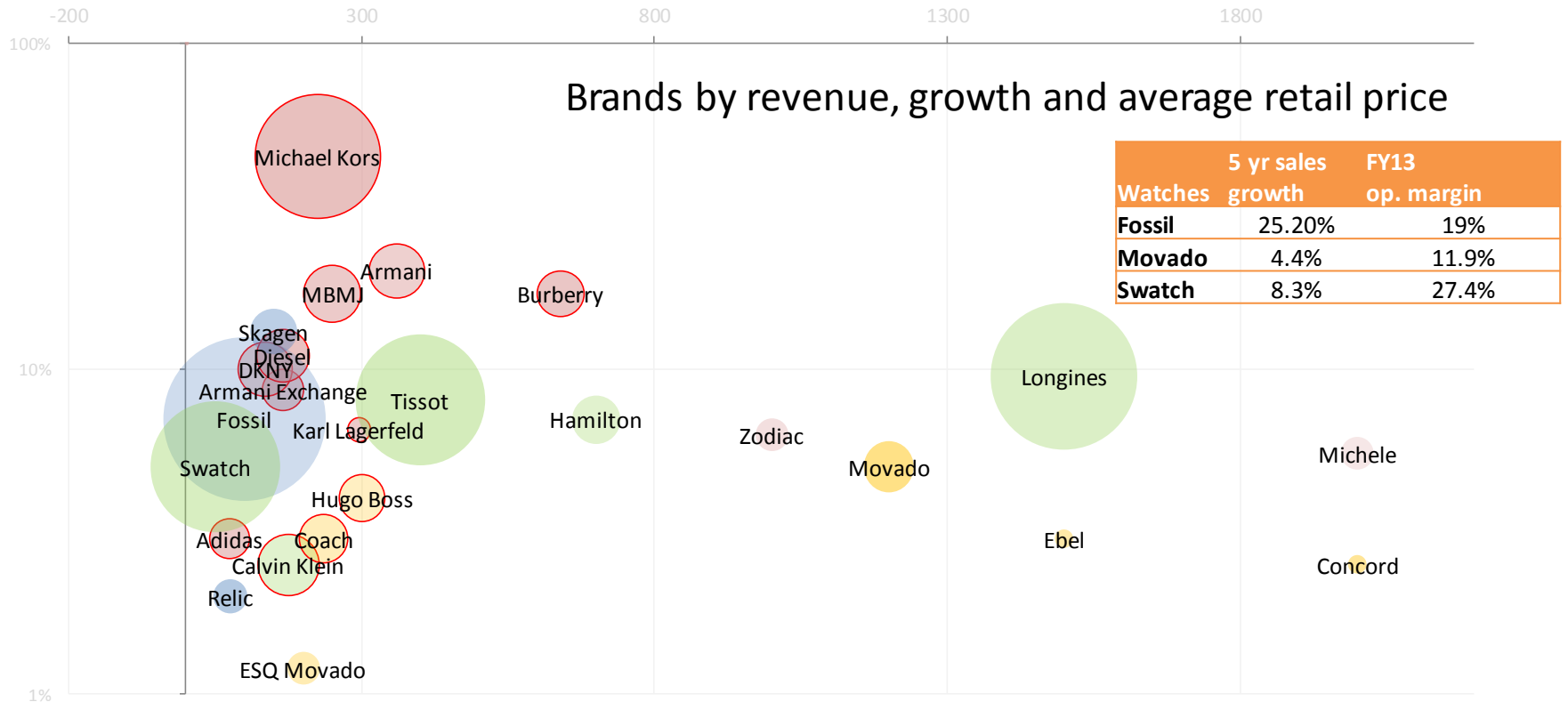
- **Established:** Burberry, Armani
- **Hot accessible:** Michael Kors, Marc Jacobs, Tory Burch

What are license agreements?

- FOSL designs, manufactures and sells licensor's products
- Symbiotic:
 - FOSL's wide distribution network enhances reach of licensor
 - Licensor carries products in its own stores
- **Scalable model:**
 - Less capex for growth
 - **Higher margins on "designer" products commanding premium price**



Price positioning and market share



- **Market leader** in \$100-600 fashion watch category
- Watch industry fragmented by price
- Unique business model: licensor for fashion brands vs traditional watchmaker

Competitive edge: execution

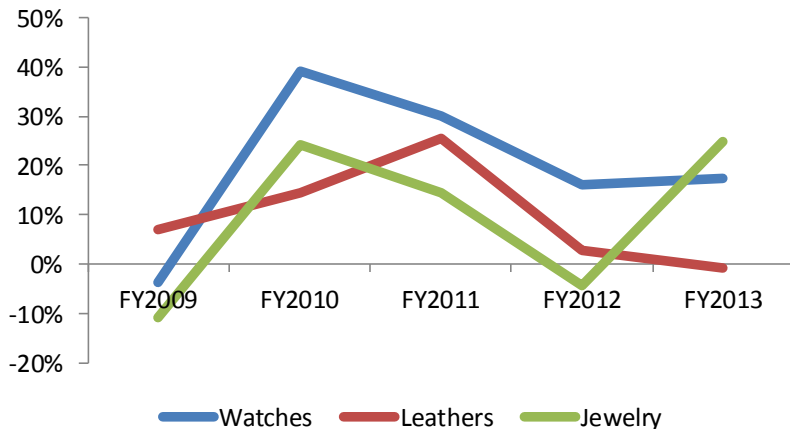
- Successful team of in-house designers: iconic designs
- 100% license retention
 - Swatch vs Tiffany settled for EUR440m
- Added jewelry lines for Armani, Michael Kors, DKNY, Diesel



Historical growth analysis

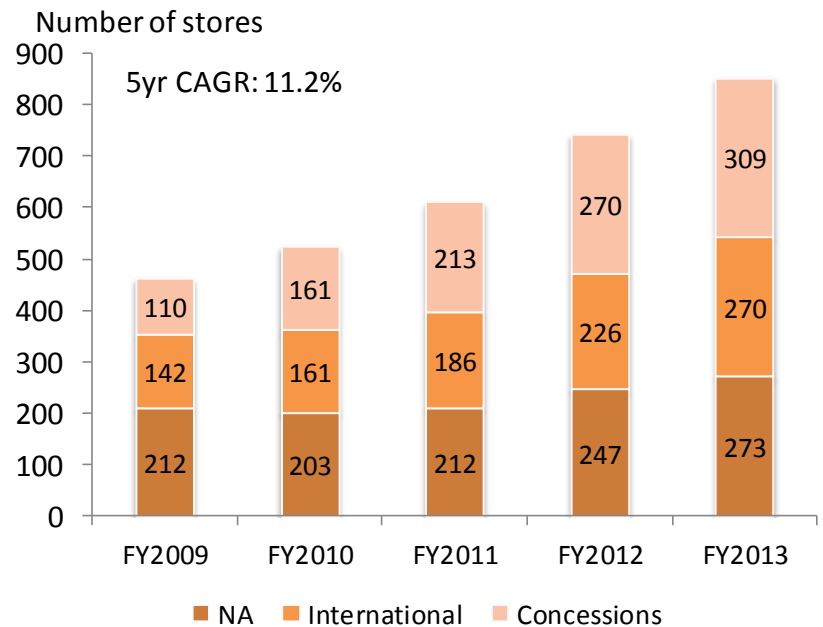
Licensed brands

- **Brand strength:**
33% FY09-13 CAGR
drove watches' outperformance of industry



Proprietary brands

- 12.5% FY09-13 CAGR
- **Store growth** in international markets



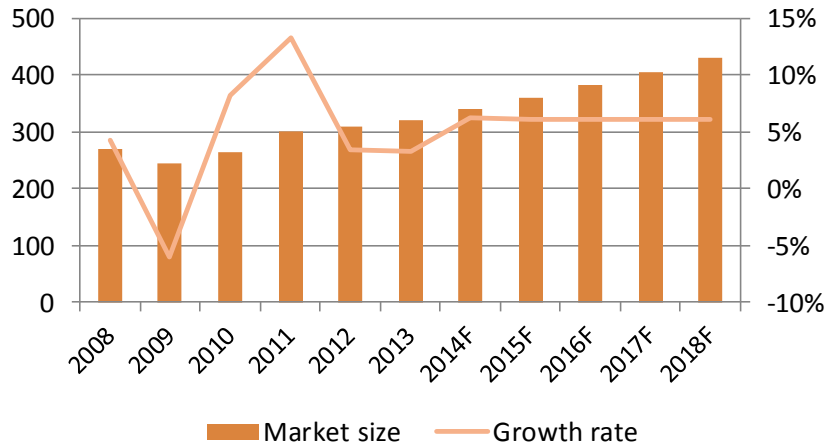
Going forward

Licensed brands

- Near term: Michael Kors, Tory Burch to power FY14-15 growth
- Long term: luxury industry expected to keep growing > GDP

Proprietary brands

- Store growth to continue: 14% FY14 guidance
- Fossil brand doing well in emerging markets
- Skagen repositioning to take effect in FY14



Potential catalysts

Android Wear: Fossil Wrist
PDA's time has come

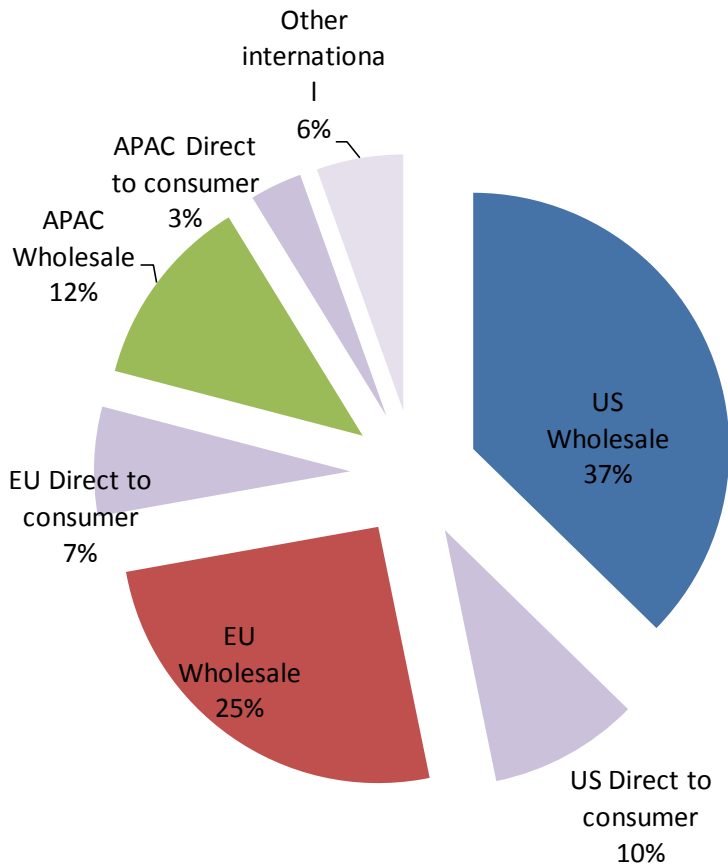
Revival of heritage brands



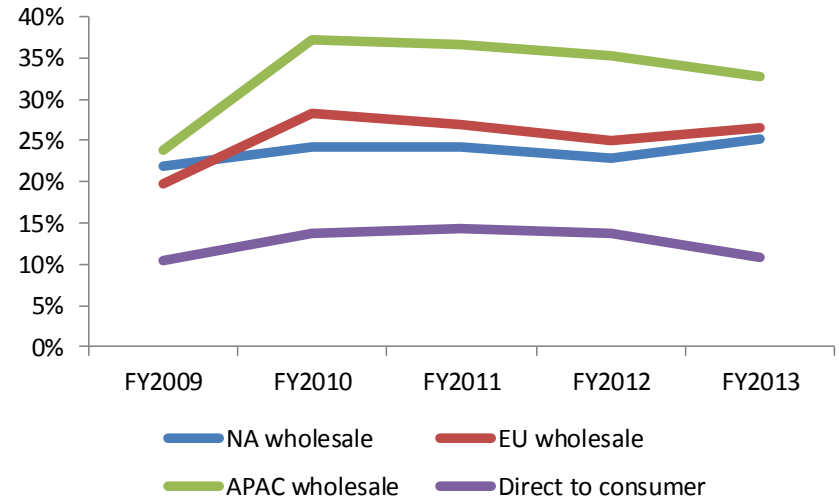
Q&A



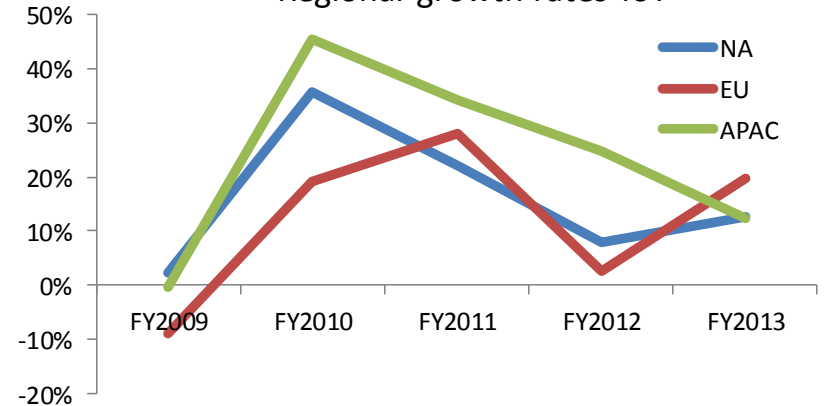
Segment breakdown



Operating margins



Regional growth rates YoY



Comp table

Average Aspirational P/E	23.2
Average Watches P/E	17.8
Average sector P/E	57.3
ex KATE	20.5

Name	Type	P/E	P/B	EV/EBITDA	5-year sales growth	EBIT margin	Net profit margin	Debt/equity	ROE	Yield (%)	Market cap (USDm)
Fossil	Watches	16.5	5.6	10.5	15.5	17.2	11.6	47.3	33.2-		5,884.3
Movado	Watches	20.8	2.3	9.6	4.4	11.9	8.9	Net cash	13.6	0.6	1,075.7
Swatch	Watches	16.1	3.2	11.7	8.3	27.4	22.7	0.6	17.6-		34,941.9
Richemont	Watches	18.9	3.4	12.3	13.9	23.4	20.4	19.0	19.2-		57,354.9
Coach	Aspirational	13.9	5.7	9.2	9.8	28.6	19.6	0.0	37.3	2.6	13,745.8
Mulberry	Aspirational	24.9	5.1	19.0	26.4	13.4	9.9	Net cash	-	0.7	702.8
Michael Kors	Aspirational	31.8	11.7	15.8	47.5	30.7	20.1	Net cash	45.7	0.0	19,006.0
Kate Spade	Aspirational	388.3-	418.4	-20.5	-3.1	4.5	Net cash	-142.1	0.0		4,311.7
Burberry	Aspirational	22.3	6.2	10.7	15.0	24.7	13.1	12.3	30.0	2.1	10,721.7
Ralph Lauren	Lifestyle	19.0	3.4	10.8	7.3	15.2	10.4	7.0	19.6	1.1	13,990.1
Hermes	Soft Luxury	33.6	9.5	19.7	16.3	32.0	21.0	2.0	27.6-		37,289.5
Kering	Soft Luxury	21.6	1.8	11.4	-10.7	18.0	0.5	43.5	11.1	2.5	26,154.2
Dior	Soft Luxury	17.9	2.4	6.6	10.8	20.4	4.7	30.5	9.8-		37,477.7
Prada	Soft Luxury	23.6	5.5	11.9	16.9	26.2	17.5	10.0	24.0	1.9	20,463.5
LVMH	Soft Luxury	20.7	2.7	9.9	11.1	20.7	11.8	31.9	13.4	2.2	100,305.6

Financial ratios

Summary table	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014F	FY2015F	FY2016F	FY2017F	FY2018F
EPS	2.07	3.77	4.61	5.59	6.56	7.46	8.52	9.59	10.34	10.75
<i>vs consensus</i>						3.52%	4.30%	1.54%	-6.62%	
ROE	14.4%	24.3%	26.4%	27.7%	35.2%	28.8%	24.7%	21.8%	19.0%	16.5%
Sales growth	28.3%	31.2%	26.4%	11.3%	14.1%	13.2%	12.8%	9.1%	6.7%	4.7%
EBITDA growth	3.0%	67.6%	22.7%	5.5%	16.0%	16.0%	15.0%	10.6%	8.0%	4.8%
EBIT growth	2.8%	77.9%	25.4%	3.6%	14.9%	14.9%	14.4%	12.5%	7.7%	4.2%
EPS growth	2.0%	82.1%	22.3%	21.3%	17.4%	13.7%	14.2%	12.6%	7.7%	3.9%
Operating cashflow	-0.6%	-16.4%	16.1%	68.5%	-3.9%	2.7%	13.4%	17.9%	11.5%	8.1%
Debt/equity	0.84%	0.93%	1.37%	6.28%	47.25%	33.16%	24.96%	19.52%	15.81%	13.20%
Debt/assets	0.64%	0.67%	0.93%	4.23%	22.78%	18.54%	15.44%	13.05%	11.21%	9.78%
Interest coverage (x)	936	343	189	95	59	102	83	94	101	82
Gross margin	54.6%	56.9%	56.1%	56.2%	57.1%	57.3%	57.5%	57.8%	58.0%	58.0%
EBITDA margin	16.1%	20.6%	20.0%	18.9%	19.2%	19.7%	20.1%	20.4%	20.6%	20.6%
Operating margin	13.7%	18.5%	18.4%	17.1%	17.2%	17.5%	17.7%	18.3%	18.4%	18.4%
Net margin	9.0%	12.6%	11.5%	12.0%	11.6%	11.8%	11.9%	12.3%	12.4%	12.3%
Inventory turnover (x)	6.30	5.46	5.25	5.64	5.71	5.62	5.62	5.62	5.62	5.62
Free cash flow to the firm	237.55	166.28	123.92	50.45	245.67	298.15	339.70	421.82	483.07	531.24
Days sales receivables	49.46	47.31	43.00	46.42	50.91	50.91	50.914	50.91	50.91	50.91
	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13		
Days sales receivables		28.52	28.027	35.15	42.17	30.55	28.84	40.37	50.91	

Margin improvement

Margins	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014F	FY2015F	FY2016F	FY2017F	FY2018F
Gross margin	54.6%	56.9%	56.1%	56.2%	57.1%	57.3%	57.5%	57.8%	58.0%	58.0%
EBITDA margin	16.1%	20.6%	20.0%	18.9%	19.2%	19.7%	20.1%	20.4%	20.6%	20.6%
Operating margin	13.7%	18.5%	18.4%	17.1%	17.2%	17.5%	17.7%	18.3%	18.4%	18.4%
Net margin	9.0%	12.6%	11.5%	12.0%	11.6%	11.8%	11.9%	12.3%	12.4%	12.3%

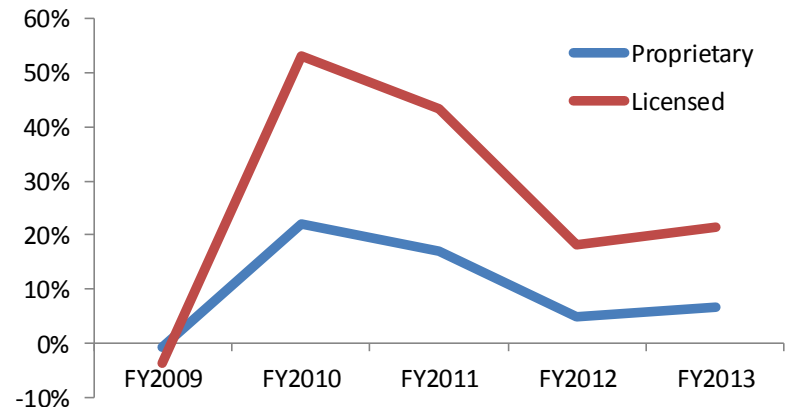
What are FOSL's license agreements?

- Exclusive worldwide agreements for manufacture, distribution and sale of fashion branded products
- Terms include:
 - Guarantee: licensor requires FOSL to guarantee minimum royalties, else pay the difference
 - Minimum sales requirements
 - Advertising commitments
 - Royalty rates: current terms are 4-20% of wholesale sales

FY09-13: ~13% of licensing revenue in royalties...

	FY09	FY10	FY11	FY12	FY13
Royalty expense	73.9	109.4	160.2	181.8	214.1
As % of licensed revenue	14.2	13.7	14.0	13.4	13.0
As % of COGS	10.5	12.5	14.2	14.5	15.3

...as licensed products have grown faster



Industry analysis

- Watch industry fragmented by price



Why licensed products?

- Watches outperformed industry FY08-13:
 - Watches: 25.5%
 - Industry: 5%
- Licensed products grew even faster at 33%
- Requires less capex, especially given flexible partially integrated production