

# Fossil, Inc (FOSL) Memo

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College/School: CLAS

Year: 2nd

## Important Company Financial Data

Nov 30 Share Price:	86.44	EBITDA:	522.75 Mn
P/E:	17.30	EPS:	5.00
52 week range:	62.77-139.20	Beta:	1.89
2011 Revenue:	2.74 Bn	Debt:	184.85 Mn
Market Cap:	5.19 Bn	Cash:	143.02 Mn

**PRICE TARGET: \$ 108**

## Thesis / Key Points

- **Fossil will continue to experience a high rate of inorganic growth through successful licensing and clever acquisitions.** Fossil has a **diverse portfolio** of globally known brand names such as Adidas, Armani Exchange, Emporio Armani, Burberry, Michael Kors, Diesel etc. for which Fossil manufactures watches and accessories. All the above companies have witnessed a **healthy sales growth** over the last few years and thus, are likely to continue to increase the number of orders and licenses to Fossil for future production. As seen in the exhibits below, the percentage of sales from these third party brands has been increasing dramatically and though it will probably peak out over the next few years, this will lead to **lower selling and administrative costs** for Fossil. Many of these licensors have **similar expansion plans** to that of Fossil, and thus it is likely that they will continue to grow at a similar pace, as the overall industry for watches and accessories grows globally. Additionally, Fossil acquired **Skagen** – A Danish designer company that produces watches and accessories in April 2012. This acquisition will help boost sales in Europe and also indicates Fossil's smart strategy of **acquisition-based growth**, in addition to proprietary and licensing growth. An exhibit below shows the **success of Skagen and Michael Kors watches** at the moment and this should benefit Fossil over the next few years. Fossil has also recently signed a deal with **Karl Lagerfeld** – German designer of multiple brands (Chanel, Fendi etc) to design some of Fossil's newer collections. It is likely that these will sell out very quickly and will help Fossil. Lastly, Fossil has already established a very strong brand presence in North America and Europe with its own brand. That's why growing inorganically in these regions in the smartest way to go for the next few years.
- **Fossil is very likely to benefit from margin expansion due to a changing sales mix and growth in developing countries.** Fossil has demonstrated two very interesting trends over the years. Firstly, as shown below in the exhibits, the percentage of watch sales in total sales has been steadily rising and will continue to do so as Fossil builds its brand through marketing itself as a **watchmaker**. An exclusive consequence of this rise in watch sales is that **gross margins will increase** because retailers usually maintain a **better margin on watches** than on accessories. In addition, once Fossil establishes itself in foreign markets as a premium watchmaker, sales of accessories will rise quickly, as customers start engaging in brand loyalty. This will ensure that overall revenues continue to grow for a sustained amount of time. Secondly, revenues show that it is **expanding successfully into the Asia Pacific region** as sales here are growing faster than overall sales. The company has also announced plans to produce for this region through **China**, and not through Switzerland, which will lead to **lower costs** and thus, better gross margins and hence, organic growth in this region. Also, the **costs of operating in Asia are lesser** than that in Europe or North America and as the Asian expansion trend continues, this should contribute to an **increase in operating margins**. Thus in Asia, their strategy is to grow the Fossil brand and then licensing strength will follow after.
- **Fossil is at the forefront of favorably changing trends in the USA and in the Asia Pacific region.** Multiple industry reports indicate that as the typical consumer gets younger in the USA, the purpose of watches changes from being utilitarian to serving as a **fashion accessory**. Furthermore, while watches were viewed as a prestigious tool and even as an investment in the late 1900s, today, this is no longer the case and is viewed more as an everyday item for those who wear watches. Fossil has been credited for bringing about this change in mainstream culture and has been aggressively partnering with more youth designers for its newer collections. All of this makes sense when **Fossil beats all other companies in market share** in the USA with 19% in 2011, a jump up from 17% in 2010. Interestingly too, in Asia another favorable trend will benefit Fossil: As disposable incomes continue to rise in India and China, people will start spending more on fashion accessories and also, stop buying counterfeit products. Recently, **Fossil entered India's markets** after the Indian government passed a new law allowing foreign companies to own 100% of a single brand retail venture (earlier, max. 51%). Lastly, growing brand consciousness in countries like India and China will only add to Fossil's sales in the Asia Pacific region, as indicated below in an exhibit. The last few 10-Ks of Fossil have explicitly stated a **strategy of expanding into Asia** by acquiring its own subsidiaries, opening more full stores and taking advantage of the **increased demand for fashion watches** and accessories. This will help Fossil develop its brand image globally, after which we may even see an increase in prices of Fossil products. All these

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growth trends **can possibly culminate into a decision to pay dividends** (not currently the case), which is a step after expansion to maintain shareholder value during expansion times.

### Misperception

Fossil does not currently have the premium valuation it deserves. In fact, it is substantially undervalued as I have shown below. This is because the markets have overreacted this year, to news of slowing growth in Asia and Europe – which is on the brink of reversal and should lead to tremendous upside for Fossil.

### VAR

Owner of a retail shop in Mumbai that sells Counterfeit products: (Translated from Hindi) “We have been going through a pretty rough patch for the last year or so. It seems like all these ‘original branded’ companies that have started shops in the city are doing good business. I think people now prefer to buy stuff from there. [...] Today, the cheaper watches that we make don’t sell as much even though they look the same. And then these people complain to the police that we are encroaching on their business when it’s the opposite.

I visited a Fossil Company store in New York. I was pleased to see that a good number of people were in it and were not just window-shopping. (This was not during Thanksgiving break). Also, I spoke to salespeople who showed me some collections. They were knowledgeable and told me that customers usually liked shopping there because they could buy watches of many companies (Burberry, Armani Exchange, Michael Kors etc) along with Fossil’s own collections. Also, I was happy to see that discounting happened more with the above-mentioned third party watches, than with Fossil watches. This will definitely help retain brand value over the long run.

### How It Plays Out

- Fossil can be expected to prosper in the changing regulatory dynamics in India, changing market preferences in the USA and resumption of growth in China.
- Expansion will create a healthier brand for Fossil globally, which it will use to build brand loyalty by being able to sell more accessories (leather, bags, shoes) to supplement increasing watch sales. We have already seen a first sign of this as Fossil introduced selling shoes in 2008 in the USA once its brand value for watches overtook that of its competitors.

### Risks / What Signs Would Indicate We Are Wrong?

- Loss of any license agreements with third party brands will lead to a loss in revenue.
- No lawsuits currently exist against Fossil, but if one does start anytime in the future then it will lead to costs and will also divert management’s attention away from innovation.
- Number of stores must continue to increase as a consequence of expansion. If this is not the case, then we must view it as a red flag.
- Failure to successfully integrate acquired businesses.
- Wide fluctuations in foreign currencies can adversely (or even favorably) impact revenues.

### Signposts / Follow-Up

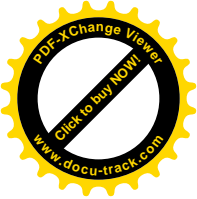
- Follow every earnings announcement to see if store-count and licensing are maintaining a healthy trend.
- Follow the level of success of Skagen and any other future acquisitions.
- Follow counterfeit market surveys and statistics because if that market continues to decline, it will be great news for Fossil
- Track Fossil’s performance in the newer markets that it enters.
- Track Gross and Operating Margins, because declines here (even though highly unlikely) can spoil the entire valuation model.

### Company Description

Fossil, Inc. a global designer, marketer and distributor company that specializes in consumer fashion accessories. The Company’s offerings include a line of men’s and women’s fashion watches and jewelry, handbags, small leather goods, belts, sunglasses, shoes, soft accessories and clothing. Its products are distributed globally through a range of distribution channels, including wholesale in countries where it has a physical presence, direct to the consumer through its retail stores and commercial Websites and through third-party distributors in countries, where it does not maintain a physical presence. The Company operates in four segments: the North America Wholesale segment, the Europe Wholesale segment, Asia Pacific Wholesale segment and the Direct to Consumer segment. Effective April 2, 2012, it acquired Skagen Designs, Ltd. and certain of its international affiliates.







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## Amazon Top Rated

Our best products based on customer reviews. Updated daily.

Any Category

Watches

Collectible

Watches

**Fashion Watches**

Pocket Watches

Sport Watches

Accessories

### Top Rated in Fashion Watches



1. **Skagen Men's 233XLTTN Titanium Watch**  
Skagen  
★★★★★ (185)  
List Price: ~~\$430.00~~  
Price: **\$63.51**  
You Save: **\$66.49 (51%)**  
11 used & new from **\$57.16**



2. **Michael Kors Women's MK5039 Ritz Horn Watch**  
Michael Kors  
★★★★★ (69)  
List Price: ~~\$225.00~~  
Price: **\$175.00**  
You Save: **\$50.00 (22%)**  
15 new from **\$169.50**



3. **Michael Kors Women's MK5020 Silver Chronograph Knurl Top Ring Watch**  
Michael Kors  
★★★★★ (59)  
Price: **\$195.00**  
8 new from **\$194.00**



4. **Invicta Women's 5377 Square Angel Diamond Stainless Steel Chronograph Watch**  
Invicta  
★★★★★ (200)  
List Price: ~~\$695.00~~  
Price: **\$109.99**  
You Save: **\$585.01 (84%)**  
6 used & new from **\$98.99**



5. **Women's Stainless Steel Quartz Chronograph Silver Tone Dial**  
Michael Kors  
★★★★★ (52)  
List Price: ~~\$225.00~~  
Price: **\$152.85**  
You Save: **\$72.15 (32%)**  
20 new from **\$152.85**



6. **Skagen Women's 358SSSD Silver Dial Mesh Bracelet Watch**  
Skagen  
★★★★★ (176)  
List Price: ~~\$400.00~~  
Price: **\$51.00**  
You Save: **\$49.00 (49%)**  
12 used & new from **\$45.90**



7. **Michael Kors Women's MK5057 Ritz Two Tone Watch (Silver)**  
Michael Kors  
★★★★★ (47)  
List Price: ~~\$225.00~~  
Price: **\$199.66**  
You Save: **\$25.34 (11%)**  
17 new from **\$189.99**



8. **Michael Kors Watches Oversized Black PU Runway**  
Michael Kors  
★★★★★ (30)  
List Price: ~~\$495.00~~  
Price: **\$155.73**  
You Save: **\$39.27 (20%)**  
22 new from **\$153.00**



9. **Michael Kors Midsized Chronograph Gold Tone Womens Watch MK5055**  
Michael Kors  
★★★★★ (39)  
List Price: ~~\$260.00~~  
Price: **\$194.99**  
You Save: **\$65.01 (22%)**  
20 new from **\$187.12**



10. **NIXON Unisex NXA1191156 Classic Analog Plastic Watch**  
NIXON  
★★★★★ (70)  
List Price: ~~\$75.00~~

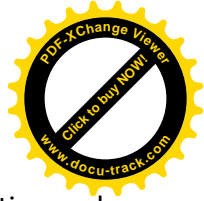
Fossil's strategy is to use its licensing and acquisition strength in the USA to grow inorganically in this region.

This picture is US-centric and we see a Skagen watch at #1 – This is the company Fossil just acquired.

Of the top 10, 7 are made by Fossil (for Michael Kors) and this indicates that this relationship will continue to grow and increase revenue for Fossil.

On the other hand in Asia, with the Fossil brand increasing in popularity (2011 Comparable store sales grew 24%) the strategy is to grow their own brand, and rely on acquisitions later.

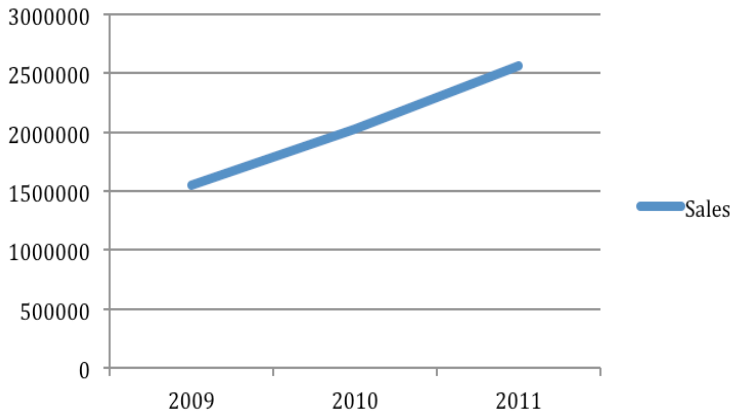
Now, the focus is to exploit all the possible organic growth available in Asia.



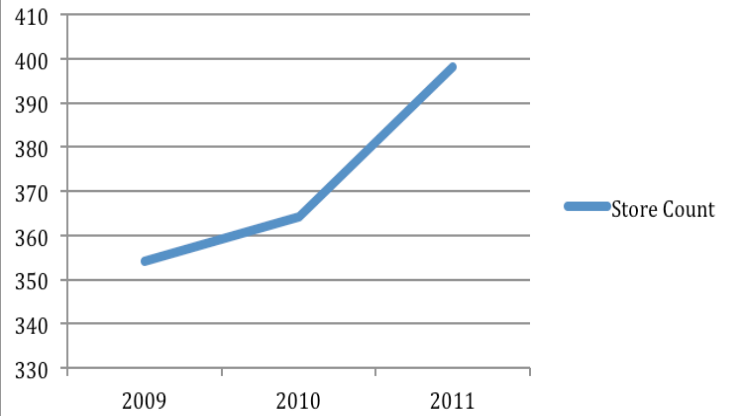
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Favorable trends (Extremely fast paced sales growth in Asia, increasing margins due to production shifting and sales mix changes, increasing store count globally, healthy and successful growth in licensing) will all continue to contribute to Fossil's upside over the next few years.

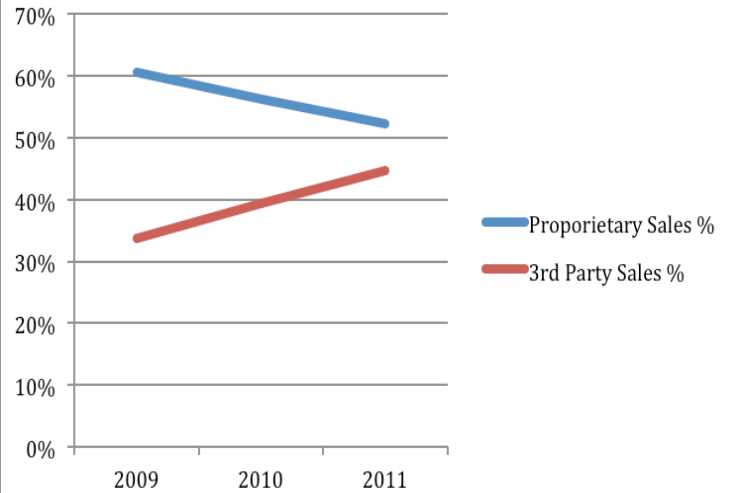
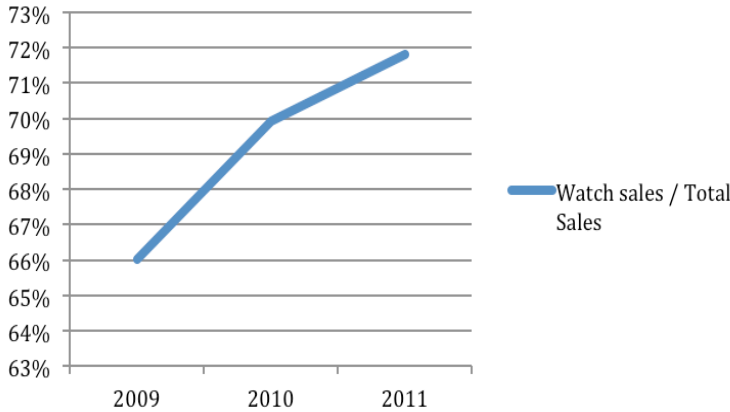
### Sales



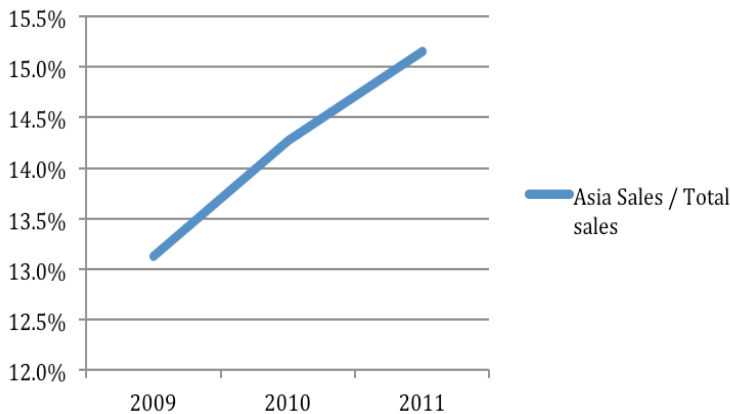
### Store Count



### Watch sales / Total Sales



### Asia Sales / Total sales



### Selling and Administrative Costs / Total Sales

