SH AGARWAL College/School: CLAS Year: 2nd

crtant Company Financial Data

Nov 30 Share Price: 86.44 EBITDA: 522.75 Mn P/E: 17.30 EPS: 5.00 62.77-139.20 1.89 52 week range: Beta: 2.74 Bn 2011 Revenue: 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 inorganicly 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 consequense 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



rowth trends can possibly culminate into a decision to pay dividends (not currently the case), which is tep 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 knowledgable 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 Operatin Margins, because declines here (even though highly unlikely) can spoil the entire valuation model.

Company Description

Fossil, Inc. a global designer, marketer and distributer 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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FOSSIL NYSE: FOSL	I	Discounte	d Cash Fl	ow Analys	sis (\$ in Tho	usands exce	ept per sha	re data)	e cité
track co.	2009	2010	2011	2012	2013	2014	2015	2016	W. do
									, T
Sales	1,548,093	2,030,690	2,567,302	2,984,073	3,434,593	3,916,832	4,428,283	4,966,043	149
Growth %	-2%	31%	26%	16%	15%	14%	13%	12%	
Cost of Revenue	703,243	875,526	1,128,116	1,245,850	1,494,048	1,694,030	1,904,162	2,122,983	149
Gross Profit	844,850	1,155,164	1,439,186	1,678,541	1,940,545	2,222,802	2,524,122	2,843,060	14%
Gross Margin	55%	57%	56%	56%	57%	57%	57%	57%	
Operating Expenses	633,223	778,750	967,195	1,120,555	1,270,799	1,429,252	1,594,182	1,738,115	129
% of Sales	41%	38%	38%	38%	37%	36%	36%	35%	
Operating Income	211,627	376,414	471,991	557,986	669,746	793,550	929,940	1,104,945	199
Operating Margin	14%	19%	18%	19%	20%	20%	21%	22%	
Net Interest Expense	235	1,119	2,391	5,257	6,941	9,047	11,662	15,242	30%
% Operating Income	0.11%	0.30%	0.51%	0.94%	1.04%	1.14%	1.25%	1.38%	
Non-Operating Income	8,506	8,915	(18,041)	11,160	13,395	15,871	18,599	22,099	19%
% Operating Income	4.02%	2.37%	-3.82%	2.00%	2.00%	2.00%	2.00%	2.00%	
Pretax Income (US)	94,543	154,318	173,861	208,639	236,670	272,127	309,169	355,777	14%
% Total Pretax Income	43%	40%	39%	37%	35%	34%	33%	32%	
Pretax Income (Non-US)	125,355	229,892	277,698	355,250	439,530	528,247	627,707	756,025	21%
% Total Pretax Income	57%	60%	61%	63%	65%	66%	67%	68%	
Total Pretax Income	219,898	384,210	451,559	563,888	676,199	800,374	936,877	1,111,802	18%
Less: Taxes	75,604	119,320	144,157	186,083	223,146	264,124	309,169	366,895	
Tax rate	34%	31%	32%	33%	33%	33%	33%	33%	
Net Income	144,294	264,890	307,402	377,805	453,054	536,251	627,707	744,907	18%
D&A	41,334	40,560	51,925	59,681	68,692	78,337	88,566	99,321	14%
% of Sales	2.67%	2.00%	2.02%	2.00%	2.00%	2.00%	2.00%	2.00%	
Capex	37,687	46,538	109,852	93,384	118,253	148,342	167,832	188,213	19%
% of Sales	2.43%	2.29%	4.28%	3.13%	3.44%	3.79%	3.79%	3.79%	
Current Assets	946,473	1,140,817	1,235,402	1,342,833	1,442,529	1,527,564	1,638,465	1,738,115	7%
% Sales	61.14%	56.18%	48.12%	45.00%	42.00%	39.00%	37.00%	35.00%	
Current Liabilities	245,280	339,488	391,278	475,489	548,309	615,457	702,793	787,084	13%
% Sales	15.84%	16.72%	15.24%	15.93%	15.96%	15.71%	15.87%	15.85%	
Net Working Capital	701,193	801,329	844,124	867,344	894,220	912,108	935,672	951,031	2%
Change in NWC	144,666	100,136	42,795	23,220	26,876	17,888	23,564	15,359	
% of Sales	9.34%	4.93%	1.67%	0.78%	0.78%	0.46%	0.53%	0.31%	
Unlevered FCF	-	-		320,882	376,616	448,358	524,877	640,656	19%
Discount Factor				0.9009	0.8044	0.7182	0.6412	0.5725	
Yearly DCF				289,083	302,941	322,007	336,574	366,800	6%
Perpetuity Growth Valuat	ion				Share Price		WACC		
WACC	11.0%		£	108	9.00%	10.00%	11.00%	12.00%	13.009
Terminal Growth of Unlevered FCF	2%		¥ .	1.00%	117.8	108.2	100.5	94.1	88.8
NPV of Unlevered FCF	1,617,406		5 9	1.50%	123.5	112.7	104.1	97.1	91.3
Terminal Year Unlevered FCF Value	7,260,768		nal G Rate	2.00%	129.9	117.6	104.1	100.3	94.0
PV of Terminal FCF	4,157,072		erminal Growth Rate	2.50%	137.4	123.3	112.5	103.9	96.9
Patamaia Valua	4,137,072 E 774 470		آي	2.50%	137.4	123.3	112.5	103.9	100.1

WACC	11.0%	ŧ	108	9.00%	10.00%	11.00%	12.00%	13.00%
Terminal Growth of Unlevered FCF	2%	وُ	1.00%	117.8	108.2	100.5	94.1	88.8
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Terminal Year Unlevered FCF Value	7,260,768	Rat	2.00%	129.9	117.6	108.0	100.3	94.0
PV of Terminal FCF	4,157,072	Ę	2.50%	137.4	123.3	112.5	103.9	96.9
Enterprise Value	5,774,478	ř	3.00%	146.1	129.8	117.4	107.8	100.1
Current Assets	1,235,402							
Total Liabilities	526,076			Upside		WACC		
Equity Value	6,483,804	£	25%	9.00%	10.00%	11.00%	12.00%	13.00%
Diluted Shares	60,020,000	5	1.00%	36%	25%	16%	9%	3%
Market Price as of (11/31/2012)	86.44	nal Gr Rate	1.50%	43%	30%	20%	12%	6%
Implied Share Price	108.03	linal Rat	2.00%	50%	36%	25%	16%	9%
Upside	24.97%	Ę	2.50%	59%	43%	30%	20%	12%
		Ĕ	3.00%	69%	50%	36%	25%	16%
Comp	anies	Ticker D/F		EV/E	RITDA			•

Companies	Ticker	P/E		EV/EBITE)A	
Coach	СОН	16.19		9.45		
PVH Corp.	PVH	19.72		12.09		
Ralph Lauren	RL	22.17		10.57		
Movado	MOV	14.81		12.2		
	Industry average	18.22		11.08		
	Using P/E:		U	sing EV/EBITDA:		
	PE Multiple	18.22		EBITDA Multiple	11.08	
	FOSL Earnings	310,180,000		FOSL EBITDA	522,750,000	
	Equity Value	5,652,255,050		Implied EV	5,790,763,125	
	Shares O/S	60,020,000		(-) Debt	184,850,000	
				(+) Cash	143,020,000	
				Equity Value	5,748,933,125	
				Shares O/S	60,020,000	
	Impled Share Price	94.17		Impled Share Price	95.78	



Fossil's strategy is to use its

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

Of the top 10, 7 are made by

Fossil (for Michael Kors) and

relationship will continue to

grow and increase revenue

this indicates that this

just acquired.

for Fossil.

licensing and acquisition

Fossil, Inc (FOSL) Memo

Amazon Top Rated

Our best products based on customer reviews. Updated daily.

Any Category Watches Collectible Watches Fashion Watches Pocket Watches Sport Watches Accessories



Skagen ***** E (185)

Skagen Men's 233XLTTN Titanium Watch

List Price: \$130.00 Price: \$63.51 You Save: \$66.49 (51%) 11 used & new from \$57.16

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

Michael Kors Women's MK5020 Silver Chronograph Knurl Top Ring Watch

Michael Kors destructive E (59) Price: \$195.00 8 new from \$194.00



Invicta Women's 5377 Square Angel Diamond Stainless Steel Chronograph Watch

Invicta ##### ₪ (200) List Price: \$605.0 Price: \$109.99 You Save: \$585.01 (84%) 6 used & new from \$98.99



Women's Stainless Steel Quartz Chronograph Silver Tone Dial

Michael Kors ***** E (52) List Price: \$225.00 Price: \$152.85 You Save: \$72.15 (32%) 20 new from \$152.85



Skagen Women's 358SSSD Silver Dial Mesh Bracelet Watch Skagen

****** = (176) List Price: \$100.00 Price: \$51.00 You Save: \$49.00 (49%) 12 used & new from \$45.90



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



Michael Kors Watches Oversized Black PU Runway

Michael Kors ***** (30) List Price: \$195.00 Price: \$155.73 You Save: \$39.27 (20%) 22 new from \$153.00



Michael Kors Midsized Chronograph Gold Tone Womens Watch MK5055

Michael Kors ###### ≅ (39) List Price: \$250.00 Price: \$194.99 You Save: \$55.01 (22%) 20 new from \$187.12



NIXON Unisex NXA1191156 Classic Analog Plastic Watch NIXON

testratestrate (70) List Price: \$75.00

10.



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

licensing and

acquisitons later.







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.











