Inter Parfums Inc. (NASDAQ: IPAR)

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Company Description

IPAR operates in the fragrance business, and manufactures, markets, and distributes a variety of both retail and prestige (designer) brands over 120 countries. Their main business model involves adding brands to their portfolio (licenses, acquisitions, introduction of new products) and supporting new and established productions. The main takeaway is that IPAR is mostly a marketing company whose success depends on its ability capture recognizable brands, segment the market accordingly, and increase awareness of such brands.

Thesis

IPAR first captured my attention with its low P/E (ttm), impressive cash position (25% of a 1.14 B market cap), and its interesting business model. There has been quite a run up since the beginning of the fiscal year, nearly doubling in price, but was mostly attributed to management raising guidance four times and beating earnings every quarter. The biggest point that needs to be addressed is the loss of the Burberry license; the gain on the buyout raised EPS (ttm) to 4.62 versus the actual 1.24. However even with the expensive forward multiple, I believe there is an opportunity due to an underestimation of brand growth despite the decoupling of earnings. I strongly emphasize IPAR's shift in business strategy and the growth of its marketing success.

Key Points

- *Unique business model with a strong balance sheet and smart management*
  - IPAR can be thought of as a **marketing company**. There are no manufacturing facilities and they act as a general contractor. IPAR sources components from suppliers which are sent to third parties based on production needs. The finished products are then sent back and are delivered to distributers (Capex is generally **less than 1.5% of net sales**)
  - IPAR works in two main segments, specialty retail and prestige (see **Exhibit 1**). In the first three quarters of the year, European based prestige products represented 84% of net sales while US operations represented 16%
  - **MISPERCEPTION:** With most products based in Europe, the weak economy is detrimental to sales.
  - **CORRECTION:** Being non-cyclical, management concluded that the "economic uncertainty and financial market volatility" in some European countries did not have a "significant impact" and do not believe it **will have a "significant impact" for the "foreseeable future."** This is mostly due to IPAR's ability to effectively segment the market and position its products efficiently despite economic downturns.
    - Moreover, a recovering European economy would booster sales. Recent economic data has shown signs of **improving consumer confidence** despite the sluggish GDP growth (see **EXHIBIT 2**).
    - There are has been recent strategies among fund managers to shift into the European market (see **VAR 1**)
  - With the recent gain on the Burberry license (later), IPAR has an impressive cash position of $287 million with virtually no debt. Management has voted on a special dividend of $0.48/share paid on December 16th to shareholders
    - Subtracting the special dividend ($13 million), management has noted that "**cash is opportunistic**" and is primarily looking to invest in its own business
  - **MISPERCEPTION:** Burberry consisted of 46% of net sales in 2012. The removal of the brand will result in a lot of search costs, reorganization, and expensive changes to its strategy
  - **CORRECTION:** As mentioned, IPAR is really a marketing company. Management has **shifted all the employee**s on the Burberry deals to new brands acquired in the last couple of quarters. The human capital that has made Burberry such a success is allocated to create the most potential.
  - IPAR's size allows them to handle worldwide launched but still allows contractors to come "in the kitchen"
- *Impressive growth from ongoing brands despite losing Burberry*
  - Burberry exercised its option to buy-out the license rights effective December 31, 2012 but IPAR had the rights to continue through March 31, 2013. The termination resulted in a gain of $198.8 million in Q4. As noted, Burberry represented 46% of net sales in 2012. (see **Exhibit 3** for comparisons)
  - It is clear that Burberry was the chief driver in its early success, but IPAR is experiencing a **CAGR of 22.8% of net sales** excluding Burberry from 2009 to estimated 2014 (see **Exhibit 4**, I believe these estimates are very conservative)
    - IPAR's independence from Burberry allows management to focus on d**iversifying its brands by acquiring new contracts as well as strengthening its own already contracted brands**
    - In Q3, Lavin represented around 12-16% of sales, Montblanc and Jimmy Choo around 15% each
    - Jimmy Choo sales has grown 56% and Montblanc has grown 57% in Q3, Lavin has been experiencing a CAGR of 11% for the past 11 years
    - **MISPERCEPTION:** The capital spent on promoting these brands will go to waste when contracts end
    - **CORRECTION:** Although contracts do have finite lives, the earliest date is 2016 while the top three sale generators have until at least 2012 (see **Exhibit 5**)
  - When compared to Q3 of 2012, ongoing sales increased by an extremely impressive **45.0%.**
  - **MISPERCEPTION:** These high increases in ongoing brand sales will slow down significantly
  - **CORRECTION:** The fragrance industry sale's CAGR (2007-2012) is 3% **while IPAR's is 10.9**%. This is a testament to IPAR's ability to capture market share and enhance its product awareness. IPAR predicts that ongoing brands sales will increase another 15% next quarter.

- So conclusively, IPAR has been refocusing its efforts on its other brands since the Burberry license loss, which have experienced gains that are more than impressive. In my crude but nonetheless conservative calculations (see **Exhibit 6**), I manage to show that so far in 2013, IPAR has managed to increase operating profits of its other brands by around threefold when compared to the same time period last year. This testifies to IPAR new commitment and shifts in strategy, and although Burberry represented a great portion of sales, I am strongly convinced by IPAR's ability to execute efficiently with both its new and old upcoming brands

- *2014 is an important year with rollouts of new products and new brands*
  - As noted, IPAR has focused heavily on advertisement and promotion for Burberry products. Shifting away, IPAR has many exciting rollouts in the following year
    - Winter: Women fragrance for Balmain (new brand)
    - Spring: Men/women fragrances for **Karl Lagerfeld** (new brand), 2 women fragrances for Agent Provocateur (new brand), women fragrance for Montblanc, men fragrance for **Brooks Brothers** (another in fall)
    - Summer: Men/women fragrances for S.T Dupont, men fragrance for Alfred Dunhill (new brand), man/women fragrances for **Banana Republic**
    - Other new brands include Shanghai Tang and **Oscar de le Renta,** more news will follow for launches in fall
  - IPAR has shifted its strategy to increasing its portfolio versus relying on a few dominant brands; 2014 is the biggest launch year for IPAR to date in terms of new brands.
    - Management expects Karl Lagerfeld to have net sales anywhere from $50 to $100 million in 2014
    - Brand recognition of specialty retail is very strong, which will benefit from the rollouts in new fragrances from Brooks Brothers and Banana Republic (see **VAR 2-3**)
    - Oscar de la Renta is a heavily recognized US based prestige brand, which will add growth to its US operations and reduce reliance on European sales (see **VAR 2-3**)
  - IPAR's competitors do not even view IPAR as a competitor (see **Exhibit 9**). IPAR's main focus on fragrances and a greater diversification across geographical regions can achieve a penetration closer to the fragrance industry.

VAR

- VAR 1: Stephen Parker, managing director at JP Morgan's private bank sector, believes that the "European economy has the strongest outlook" with "growing consumer confidence." He has personally allocated his portfolio strategy to European ETFs and stocks that correlate with strong consumer confidence, a move he believes that other funds are doing/about to do.
- VAR 2: Survey of average consumer, see **Exhibit 7**
- VAR 3: Survey of fashioned inclined consumer, see **Exhibit 8**
- VAR 4: Eleanor Powell, executive director at *The Estee Lauder Companies, Inc*., see **Exhibit 9**
- VAR 5: Olga Levinzon, director at *COTY, Inc*., see **Exhibit 9**
- VAR 6: Natalija Jovasevic, director at *AVON Products Inc.* (expected call at 11 AM 12/4. Not part of application, but will update)
- VAR 7: Fred Buonocore, VP at *The Equity Group, Inc*., provided insight on who IPAR considers as competitors, see **Exhibit 9**

How It Plays Out

Combing IPAR's new focus on enhancing the brand awareness of ongoing brands and its proven success along with the recent strategy of stronger diversification and portfolio enhancement, I believe IPAR has a promising future. However, management has predicted EPS for 2013 to be $1.23, which translates into negative earnings of ($0.17) for Q4. Management expects a gross margin of roughly 55-56% with SG&A 68-70% of net sales (40-45% are advertisement and promotion). This increase in A&P is for current products and reflects their determination to strengthen ongoing brands. As for the next fiscal year, earnings are lower due to the massive sell off Burberry this quarter that boosted Q1 earnings and that A&P levels are over 20% for 2014. Management expects net sales of $495 million, which is slightly more than net sales in 2010. So is it a negative sign that it takes IPAR 1.5 years to increase net sales to what it was 2 years ago? Given the large influence of Burberry brands and its effect on nets sales, I believe IPAR's growth without the brand is more than impressive. The P/E is definitely not cheap, so I do not have the strongest conviction that this is the right time to buy. However, my conviction lies on IPAR's ability to continually to beat earnings, inherent of increase in ongoing brand sales and new product rollouts.

Risks / What Signs Would Indicate We Are Wrong?

- Marketing efforts are not as effective and does penetrate the fragrance market as strongly
- The new brands acquired do not hold as the brand power as I assumed it would carry over
- The stock starts to trade more on value a basis versus the growth potential it seems to reflect. I'm worried that the lower earnings will scare of invest despite its internal revenue growth.

Signposts / Follow-Up

- Market reaction after the next annual report due to multiple expansion with EPS of around 1.23 (vs. 4.26)
- New contracts IPAR signs, gauge the level of brand power and advertisement/promotion needed
- New fragrance brands by competitors
- European economy, specifically consumer confidence and per capita GDP growth

Important Company Financial Data (Yahoo! Finance)

Price:	$36.616	Total Cash: $287.64 Million
P/E (ttm):	7.83	Total Debt: $0.265 Million
EPS (ttm):	4.62	Debt/Equity: 0.05
P/E (forward):	29.83	Employees: 312
52-Week	$18.91 - $38.94	Institutions owned: 51.40%
Market Cap:	$1.14 Billion	Insiders owned: 46.19%
Div & Yield	$0.48 (1.30%)	Short as % of Float:

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Exhibit 1: Current Brands

	prestige	specialty retail	
US	Agent Provocateur	BANANA REPUBLIC	US
US	ALFRED DUNHILL	bebe	US
US	ANNA SUI	BETSEY JOHNSON	US
Europe	BALMAIN	Brooks Brothers	US
Europe	BOUCHERON	GAP	US
Europe	JIMMY CHOO	lanebryant	US
Europe	LANVIN	NINE WEST	US
Europe	MONT BLANC		
Europe	NICKEL		
Europe	Paul Smith		
Europe	Repetto		
US	SHANGHAI TANG		
Europe	S.T. Dupont		

Exhibit 2: European Commission Economic Sentiment Indicator Eurozone

Bloomberg News Survey of 31 economists has the highest reading since August 2011 (27-month record).

Exhibit 3: Effects of Burberry License Termination Calculations

	Including Burberry	**Excluding Burberry**
Net Income (2012)	$121.1 million	$38.1 million
EPS (2012)	$4.26	$1.24
% Change in Ongoing Brands (Q3 2013 from Q3 2012)	(23.9%) ($166.6 million to $126.8 million)	45.0% ($87.2 million to $126.8 million)
% Change in European Based Operations (Q3 2013 from Q3 2012)	(34.0%) ($148.6 million to $98.1 million)	41.2% ($69.5 million to $98.1 million)
% Change in US operations (Q3 2013 from Q3 2012)	N/A	62.3% ($17.1 million to $28.7 million)
Net Sales (Q1 2013)	$213.81 million	$104.77 million (51% of total)
Net Sales (Q2 2013)	$117.44 million	$98.23 million (84% of total)
Net Sales (Q3 2013)	$126.80 million	$126.80 million (100% of total)
Net Sales (first three quarters)	$458.05 million	$329.79 million (72% of total)
	Q3 2012	**Q3 2013**
Gross Margin	60.8%	52.2%
SG&A (% of Sales)	47.5%	43.7%
Operating Margin	13.3%	11.6%
Diluted EPS	$0.33	$0.25

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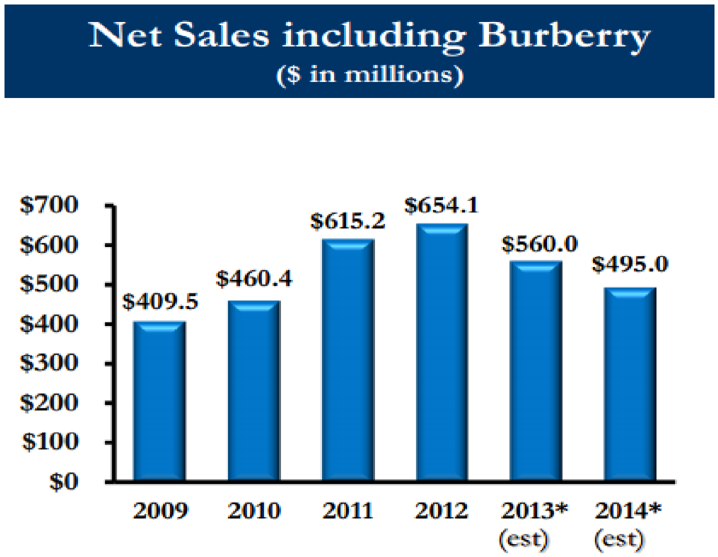
Exhibit 4: Growth of Sales



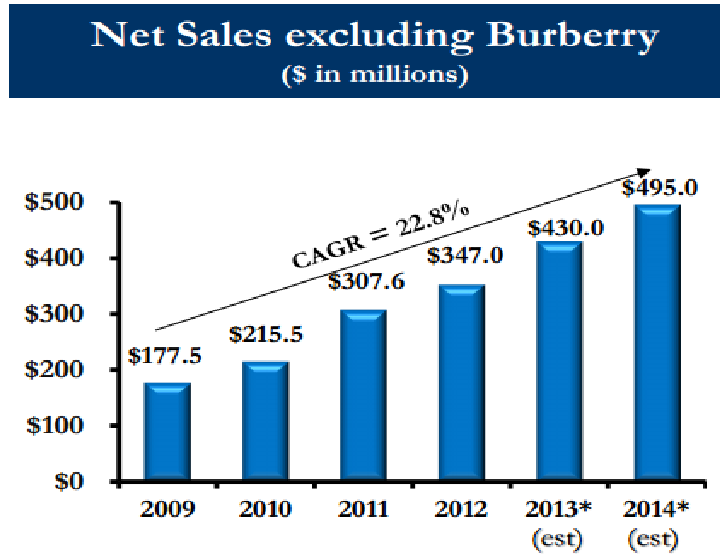


Exhibit 5: Expiration Dates

Brand Name	Licensed Expiration Date
Burberry	December 31, 2012
Jimmy Choo	December 31, 2021
Van Cleef & Arpels	December 31, 2018, plus a 5-year optional term if certain ales targets are met
Montblanc	December 31, 2020
Paul Smith	December 31, 2017
S.T. Dupont	December 31, 2016
Boucheron	December 31, 2025, plus a 5-year optional term if certain sales targets are met
Balmain	December 31, 2023
Repetto	December 31, 2024
Alfred Dunhill	September 30, 2023, subject to earlier termination on September 30, 2019, if certain minimum sales are not met
Anna Sui	December 31, 2021, plus two five-year optional terms if certain conditions are met
Karl Lagerfeld	October 31, 2032

In connection with the acquisition of the Lanvin brand names and trademarks, Lanvin was granted the right to repurchase the brand names and trademarks in 2025 for the greater of €70 million (approximately $90 million) or one times the average of the annual sales for the years ending December 31, 2023 and 2024.

Exhibit 6: "Operating Power" Calculations

Since 2013 is when Burberry sales faded out, I compared the "operating power" of the first three quarters of this year ("period 2") versus last year ("period 1"). This is a very rough sketch but my assumptions are conservative and should demonstrate what I want to show. I want to segment operating profits attributed to Burberry and all others. Burberry has higher gross margins, where 45% of net sales are Burberry will generate a gross margin of 66% on average in "period 1". According to the earnings call this quarter, all other brands have an average around 55% gross margin. So with the total sales of $478 million, solving the equation [X% * (0.45 * 478) + 55% (0.55 * 478) = 66% * (478)] for X gives a gross margin of roughly 70%. It is extremely hard to bring out the variation in SG&A, but historically SG&A as a percentage of net sales has been higher with Burberry products when compared to 2013. In order to be very conservative, I will underestimate and say SG&A of Burberry are the same SG&A of all other brands in proportion to net sales. Since we are only worrying about bottom line estimates, the calculations by % will show consistent results. I assume other expenses after operating expenses to be irrelevant (see **Appendix 3** for more).

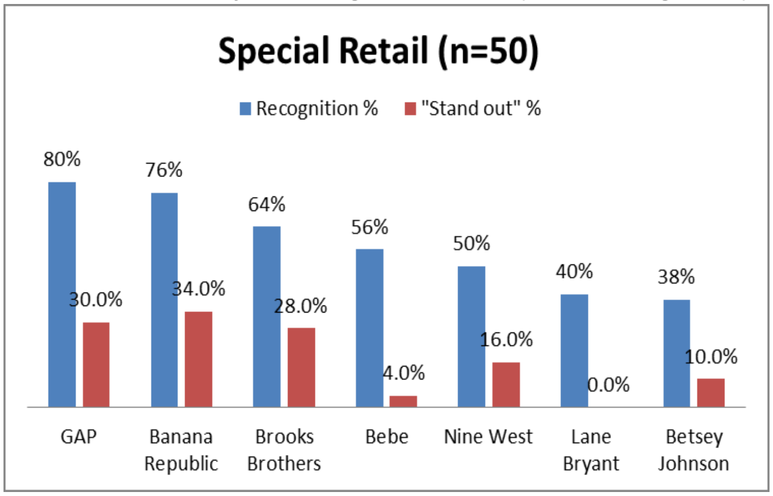
In "period 1" (millions)
Net Sales: $478
Gross Profit: $295.5
SG&A: $229
Gross Profit of Burberry: $150.5
SG&A of Burberry: $103
Operating Profit of Burberry: $47.5
Gross Profit of others: $145
SG&A of others: $126
Operating Profit of others: $19

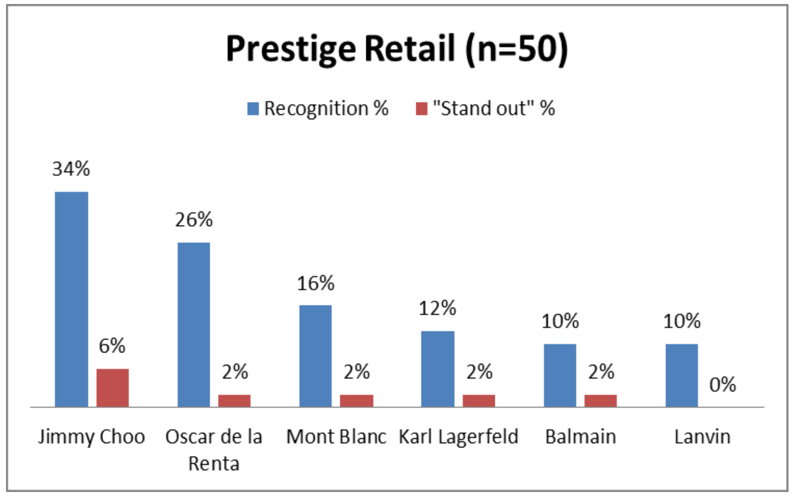
In "period 2" (millions)
Net Sales: $459
Gross Profit: $268
SG&A: $179
Gross Profit of Burberry: $90
SG&A of Burberry: $50
Operating Profit of Burberry: $40*
Gross Profit of others: $182
SG&A of others: $129
Operating Profit of others: $53

Margins of Error based on
Total Gross Profit: 1.5% (268 vs. 272)
Total Operating Profit: 3.4% (89.5 vs. 93)

*Most noticeable error is in "Period 2" where operating profit of Burberry is 84% of "Period 1" even when gross profit is 60% of "Period 1." This is most likely due to the massive selling attempts by IPAR to reduce all Burberry products, resulting in lower gross margins for Burberry in "Period 2," which would reduce the gross profit to more consistent levels with "Period 1." However, changing the gross margin for Burberry products in "Period 2" would not have drastic effects in the error margins since "operating profit of others" would not change.

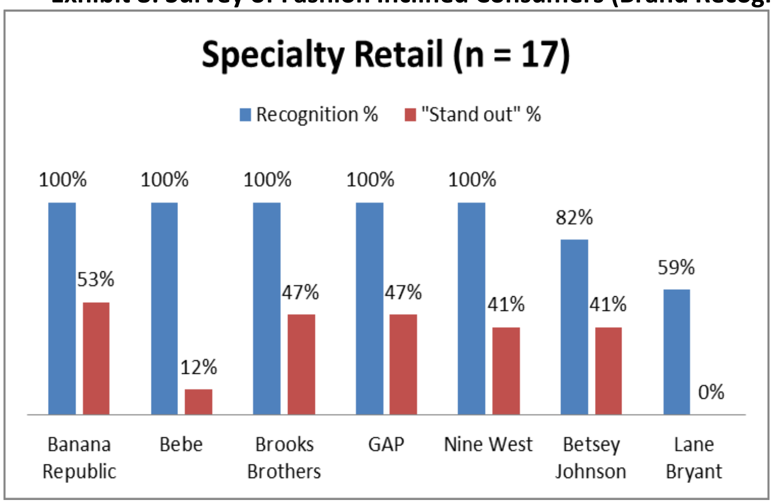
Exhibit 7: Survey of Average Consumers (Brand Recognition)*

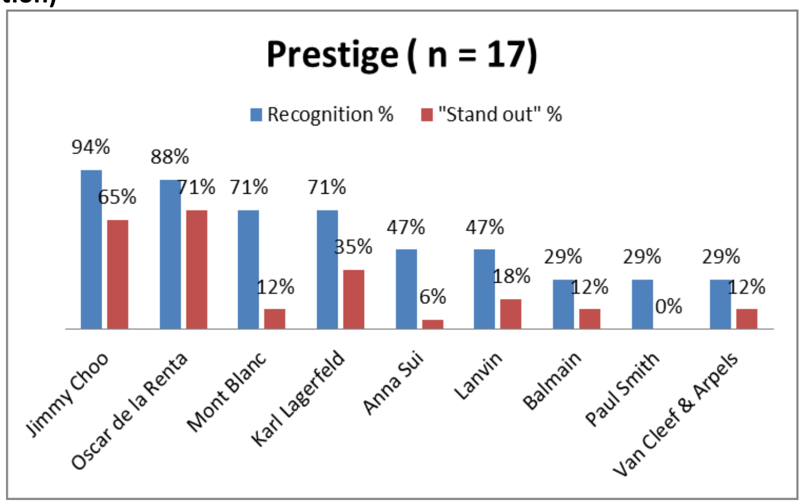




* "Stand out" % is the number of times the brand "stands out" to the consumer divided by the total number of brand recognitions

Exhibit 8: Survey of Fashion Inclined Consumers (Brand Recognition)*





* "Stand out" % is the number of times the brand "stands out" to the consumer divided by the total number of brand recognitions

Exhibit 9: Competitor Analysis

	Inter Parfums Inc.	Estee Lauder Inc.	COTY Inc.	Sector
Competitors (VAR)	COTY, Estee Lauder, P&G, Louis Vuitton, L'Oreal,	L'Oreal, Chanel, Dior	L'Oreal, Dior, P&G, Louis Vuitton, Chanel, Puig, Estee Lauder	L'Oreal, Estee lauder, Louis Vuitton, Chanel *(Biggest Names)*
% of Fragrance Sales	100% of operating income	8% of operating income	92% of operating income	N/A
Geographic Breakdown of Fragrance Sales (VAR)	46% EMEA, 35% AMER, 19% APJ	50% in EMEA, 40% in AMER, 10% in APJ	41% in AMER, 47% in EMEA, 12% in APJ	45% EMEA, 33% AMER, 22% APJ
Noticeable Brands	Jimmy Choo, Lanvi, Mont Blanc, Oscar de la Renta	Tom Ford, Armani, Tommy Hilfiger, Michael Kors	Adidas, Calvin Klein, Playboy, Chloe	Burberry, Chanel, Armani, Tom Ford
P/E	7.83 trailing, 29.83 forward	28.87 trailing	36.90 trailing	32.64 trailing
Main Takeaway	IPAR focuses mainly on prestige fragrances while most other competitors have a wide range of business segments. Interestingly, these companies do not even view IPAR as a main competitor. Moreover, IPAR has the closest geographic breakdown of fragrance sales when compared to the sector. Some of the biggest brands like Estee Lauder and P&G have relatively small percentage of income attributed to fragrances. I believe IPAR's strategic marketing, low profile status among competitors, and entirely focused efforts on fragrances allow IPAR to grow aggressively.			