

The Fox Fund



Initiating Coverage Report

Ralph Lauren Corporation. RL (NYSE)

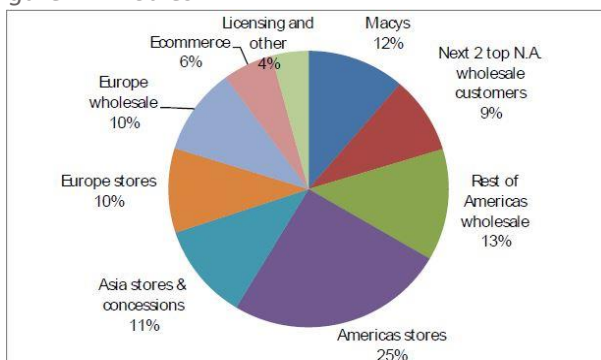
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Company Overview

Ralph Lauren Corporation is a global company that designs, markets, and distributes apparel and accessory products. The company's products are in department stores, specialty stores, and golf shops, retail stores, shops within shops, and e-commerce sites. The company sells men, women, and children's appeal, accessories, footwear, eyewear, watches, jewelry, handbags and luggage, home furnishings, paints, and fragrances. Ralph Lauren's apparel labels are: (in order of overall product margin, thesis important brands in bold):

1. Purple Label
2. Black Label
3. Blue Label
4. **Club Monaco**
5. RRL
6. Ralph Lauren Childrenswear
7. Polo Ralph Lauren
8. Ralph Lauren Golf
9. **Upcoming Women's Collection**
10. Lauren by Ralph
11. Denim & Supply Ralph Lauren
12. RLX Ralph Lauren
13. Rugby
14. **Chaps**

Figure 1: RL Sales Mix



Source: Company reports and Wells Fargo Securities, LLC estimates

Recommendation	BUY	
RL	\$153.09	
Target Price	\$184.99	
Projected Return	20%	
Market Data		
52wk Range	\$192.03-\$146.00	
Market Cap (\$mm)	13,967.5M	
Dividend Yield	1.16 (6.25% YoY growth)	
Earnings History		
Date	Revenue (\$bb)	EPS
2010	4.979	4.82
2011	5.660	5.78
2012	6.860	7.23
2013	6.945	8.13
2014 (est.)	7.413	8.43
2015 (est.)	8.039	9.24

Investment Thesis Overview:

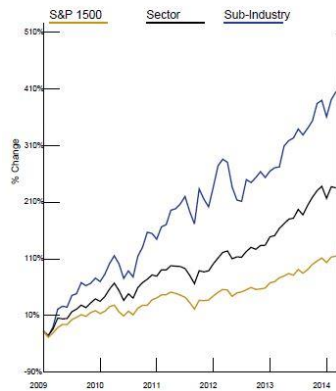
RL is currently undervalued to itself on a three year price to earnings multiple. Our sector believes the market overreacted to RL's re-integration of the lower margin Chaps clothing line for strategic control reasons, which will lead to compressed operating margins going forward, compounded by industry-wide international currency unfavorability this quarter. Moving forward, increased market penetration in China with high margin product lines, coupled with wholesale resurgence in Europe, strengthening American retail sales, and exponential gains in e-commerce, will cover margin compression losses with sales volume increases.

Industry Overview and Relevant Macro-Economic Trends

Industry Performance

GICS Sector: Consumer Discretionary
Sub-Industry: Apparel, Accessories & Luxury Goods

Based on S&P 1500 Indexes
Five-Year market price performance through
Mar 20, 2014



NOTE: All Sector & Sub-Industry information is based on the Global Industry Classification Standard (GICS)

Industry:

The Apparel sub industry has grown at a rate of 27.1% YOY compared to the 24.0% YOY increase of the overall market (S&P 1500), and the US Census Bureau estimates clothing and clothing accessories sales make up about 5.5% of that growth. However, the upcoming year has tempered expectation at best, as retail sales were the most effected by unseasonal inclement weather. Clothing retail is especially expected to miss YOY revenue marks due to colder weather delaying demand for spring fashion lines, whereas last year's lines debuted earlier than normal due to the irregularly warm temperature in early 2013. RL acknowledged this sentiment in its last earnings call, noting "lower traffic to many of our brick-and-mortar formats during the quarter" but also emphasized strong E-commerce and higher units per transactions this quarter as off-setting factors.

Domestic Macroeconomic:

Though the overall consumer confidence index is at a six year high (currently at 82.3), consumer discretionary spending as a whole has seen a shift from the price conscious consumption of the early recession exit, to a more utility driven consumption pattern. Consumer purchases are skewing toward larger, longer lasting products, such as home durables and automotive, rather than the balanced purchasing that is expected in a post-recession environment. In clothing retail, this consumption shift is towards accessories and shoes, as these products are seen as more "bang for your buck." As a lifestyle brand with multiple home non-durable and accessory product lines, RL is in a better position than most of its comps to take advantage of this market trend.

Notable Foreign Macroeconomics:

Europe:

As shown in the Appendix figure, Europe consumer confidence has steadily risen since 2013, despite sovereign debt issues and civil unrest. Overall economist sentiment is positive towards European recovery, but risks linger with possibilities of a Ukraine/Russia war going forward.

China:

While growth in China has decelerated from prior years, luxury brands still see a huge opportunity for expansion in China's tier 2, 3, and 4 cities. In addition, the growing popularity of e-commerce in China creates a big opportunity for high-end retailers to reach an untapped, growing, Chinese middle-class.

Investment Thesis:

Last quarter, RL announced it is continuing its trend of reintegrating its licensed brands with a reintroduction of its Chaps clothing line. RL feels it has better strategic control of quality and overall direction of its products with licenses in-house. Because of this reintegration, the Chaps operating expenses are projected to increase over the next three years. Along with this announcement, the company earnings saw heavy pressure from unfavorable currency translation in its East Asian and South Pacific geographic segments, compounding earnings growth for the quarter. Upon this news, P/E drops from 22.44x to 18.47x, and has hovered around this range since. Though RL itself has yet to give guidance on exactly how much the Chaps reintegration will effect EBIT, analysts are projecting EBIT compression in the 100 to 200 basis point range.

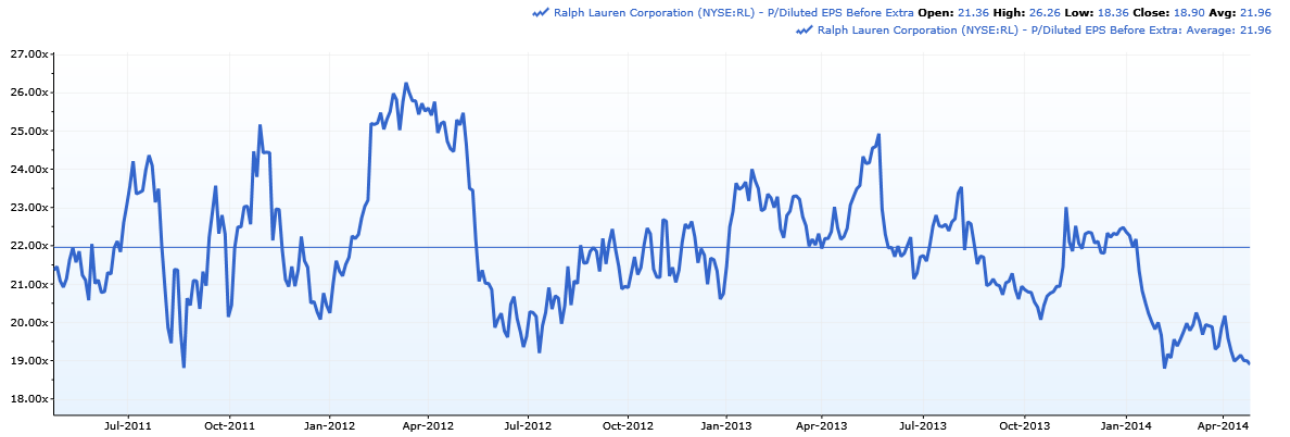
Our sector expects the multiple compression to be reversed due to high margin products covering losses incurred with the reintegration. Ralph Lauren existing high margin product lines are seeing explosive growth overseas, and should cover margin expansion losses this year with higher sales volume with higher overall gross margin. Specifically, our sector sees continued growth with Club Monaco in Japan, Ralph Lauren purple label in China, and Polo Ralph Lauren wholesale in Europe.

Three year share price v.s. p/e v.s.

RL's Last Earnings Report



Three year P/E chart



USD to JPY currency cross



Financial Analysis:

Revenue:

- 2013 revenue was \$6.944 Billion
 - Increasing since 2010
 - 11.7% three year CAGR
 - 1.2 YOY growth
 - Growth slowed by weak wholesale results in American markets
 - Offset by better than expected American retail segment growth



Operating Income

- YOY growth fell to 9.8 CAGR from 24 CAGR the previous year
 - Higher SG&A with a transfer to S&P and increased advertising to stay competitive in last year's cutthroat holiday sales environment contributed to the decline in growth

Cap Ex

- In FY 13, the company spent \$276.5 million on capital expenditures
 - Opening of 20 new Ralph Lauren and 14 new Polo factory stores and launched Ralph Lauren and Club Monaco websites in Japan and Canada.

Inventory turnover and general efficiency

- Inventory turnover decreased to 3.21 to 3.71 for the last quarter
 - \$50 Mil increase in total inventory from last year due to equal parts product line reintegration and weaker sales in specific products.

Liquidity

- Quick ratio decreased from 1.83x to 1.57x
 - Largely due to inventory increase
 - RL has a untapped \$500 Mil credit line

Solvency

- No long term debt

Bear Factors:

Dependence on Wholesale Partners

45.2% of RL's revenue comes from Wholesale partnerships, with 12% of total revenue coming from Macy's. In this way, RL's wholesale segment is directly tied to the sales effectiveness of its partners. As detailed in the accompanying graph, Macy's sales have slowed YOY, but are projected to spike upward in the coming year. In addition, Ralph Lauren wholesale to retail ratio has trended downward since 2009 (wholesale was 57% of total revenue in 2009) and we expect that trend to continue with retail locations increasing and e-commerce growth.



Supply Chain Partners

Colored by last sales surprise



Macy's Revenue projections

Brick and Mortar Sale Stagnation in East Asia

70% of current geographic penetration in Asia is currently through Korea and Japan. Though RL's marketing efforts have kept negative comp growth in those sectors at a fairly controllable level, the overall prospect of that segment is bleak. On the bright side, explosive E-commerce sales growth in that region is creating net positive sales for the segment as a whole.

Bull Factors:

Resurgence of European geographic segment

20% of Ralph Lauren's revenue comes from European retail and wholesale operations. With a resurgence of consumer confidence in the Eurozone, Ralph Lauren should see sale growth in the near term for RL's 27 retail and 40 factory store locations throughout Europe. In addition, RL should see an increase in orders from Italian and Spanish wholesale partners for the first time in 5 years, when those countries were RL's top two wholesale markets. RL management announced in their last earnings call that it is building a flagship store in London to be opened at the end of this year, further committing it to the geographic segment.

RL is mostly shielded from Russian market volatility due to its Russian operation being 100% licensed.

Growth in China

As previously mentioned, there is large market penetration potential in China's tier 2, 3, and 4 cities. RL has slowly building brand awareness in the area with low margin product advertising and store openings. Ralph Lauren plans on building a Flagship store in Hong Kong, with an undisclosed amount of stores to be opened in China this year, and is seeing heavy yet sustainable growth in the Chinese wholesale segment.

Growth in E-commerce

RL has devoted a significant amount of CAPX to building a stronger E-commerce presence. In its last earnings call, RL announced YOY e-commerce comp growth in the high teens for North America, and E-commerce revenue growth of 50%. Club Monaco, RL's high margin international presence, experienced 70% revenue growth YOY. Management expects this trend to continue into the future, and our sector has no reason to believe otherwise.

Debut of Women's Polo

Women's Polo is a new varying margin product line slated for fall 2014. Similar to the Men's Polo line, the brand will cater to mid to high price ranges, and management has announced that this product line will be sold exclusively in high end department stores such as Bloomingdales and Nordstrom's, limiting market cannibalization from the Lauren by Ralph Lauren line, which is exclusively sold in Macy's. The brand should accelerate sales and cover some of the margin compression from the re-integration from the Chaps license.

Relative Valuation

RL's comp group consists of the following companies:

PVH Corp – Retailer and wholesaler and owner of the Calvin Klein, Tommy Hilfiger, and Heritage Brands brands

VF Corp – Retailer and wholesaler and owner of the Timberland, Wrangler, Jansport, and The North Face Brands

Guess – Retailer with a smaller wholesale segment. Direct competitor in terms of product margins among retailers. Operates the Guess men's and women's lines

Michael Kors – high growth designer retailer and wholesaler. Operates in RL's direct product margin and is a direct competitors in most global segments.

Our sector has chosen to forgo a relative valuation of RL. The capital structure variation of PVH, negative earnings growth of Guess, and exponentially large growth of Michael Kors in the short term skew valuation, and therefore this valuation technique cannot be used as a feasible source to derive arbitrage potential.

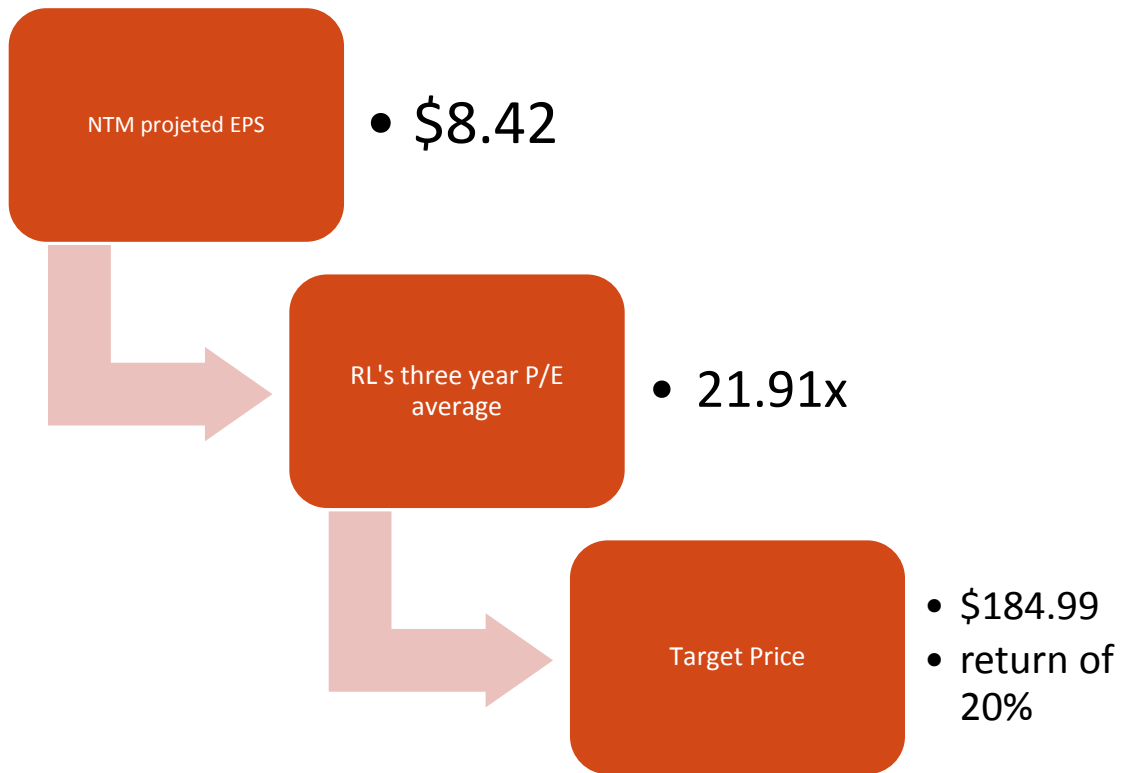
Ralph Lauren Co. Comparables Analysis															
(\$ in millions except per share)															
Company	Stock Price "04/27/14"	Capitalization		Valuation Multiples		Efficiency		Projected Growth Rates			Margins		Liquidity		Leverage
		Equity Market Value	Enterprise Market Value	P/E Multiple LTM	Multiple NFY	Inventory Turnover LFY	Inventory to Cash Days	Revenue Growth NTM	EBIT Growth NTM	EPS Growth NTM	Income Margin LTM	EBITDA Margin LTM	Quick Ratio	Credit Drawn %	LT Debt/Equity MRQ
Ralph Lauren (RL)	\$153.09	\$13.83	\$12,715	19.3	18.7	3.21x	139.74	6.7%	-2.6%	3.6%	10.8%	20.0%	1.57x	2.6%	0.0%
PVH (PVH)	\$ 122.24	\$10.05	\$13,431	16.3	10.7	3.67	124.6	5.9%	77.1%	51.3%	1.8%	10.5%	0.85	0.0%	89.3%
VFC (VF)	61.44	\$27.06	28,427	20	13	4.31	125.64	7.7%	12.9%	12.6%	10.6%	16.2%	1.36	1.4%	23.5%
Guess (GES)	26.74	\$2.27	1,797	17.4	6	4.42	124.9	-1.0%	-15.2%	-20.1%	6.0%	12.6%	2.12	0.0%	0.6%
Michael Kors (KORS)	89.88	\$18.33	17,501	23.4	13.1	3.85	122.31	47.2%	53.7%	58.1%	18.2%	31.4%	4.13	5.7%	0.0%
Median				18.7	11.9	4.1	124.8	6.8%	33.3%	31.9%	8.3%	14.4%	1.74	0.7%	12.1%
Mean				19.3	10.7	4.1	124.4	15.0%	32.1%	25.5%	9.1%	17.7%	2.12	1.8%	28.4%

Source: Bloomberg

[↗ Ralph Lauren Corporation \(NYSE:RL\) - P/Diluted EPS Before Extra](#) **Open:** 21.36 **High:** 26.26 **Low:** 18.36 **Close:** 18.90 **Avg:** 21.96
[↗ Ralph Lauren Corporation \(NYSE:RL\) - P/Diluted EPS Before Extra](#) **Average:** 21.96
[↗ Index: PVH, VFC, GES, KORS \(Market Cap\) - P/Diluted EPS Before Extra](#) **Open:** 21.84 **High:** 28.32 **Low:** 16.33 **Close:** 27.04 **Avg:** 21.83
[↗ Index: PVH, VFC, GES, KORS \(Market Cap\) - P/Diluted EPS Before Extra](#) **Average:** 21.83

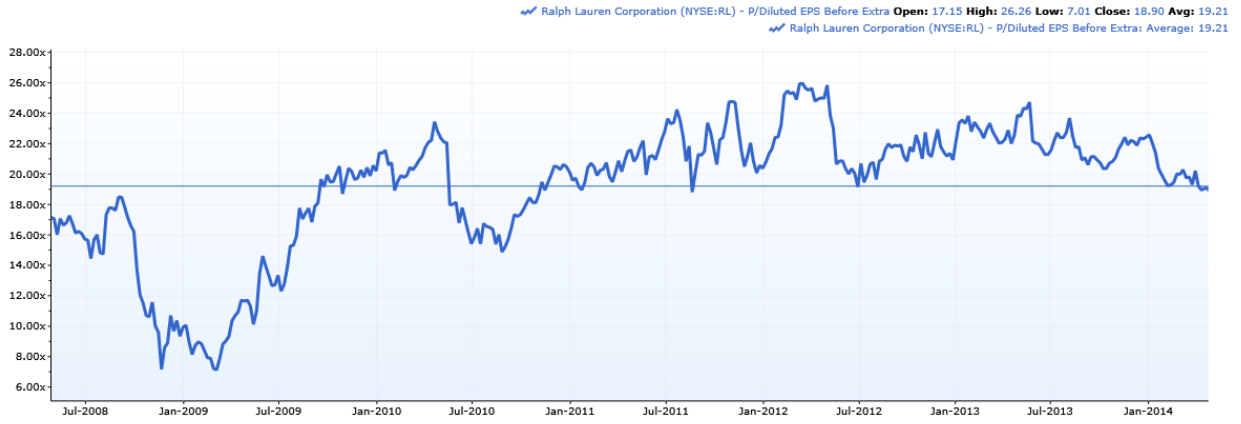


Historical Valuation



Appendix

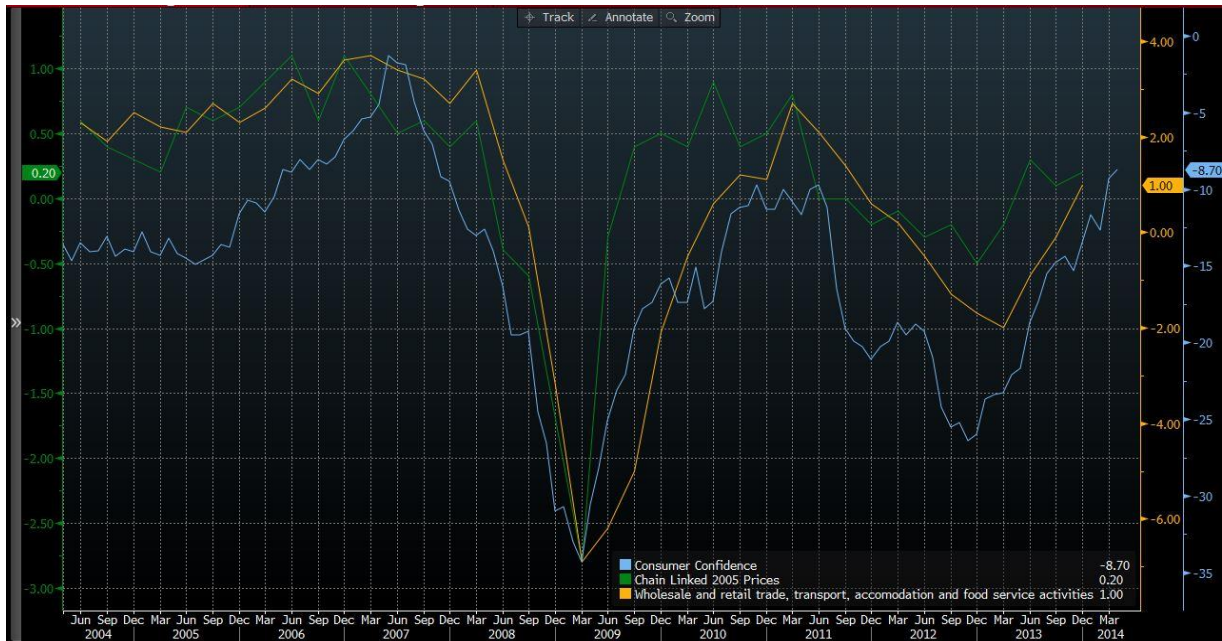
Five year P/E



Five year P/E with comp index (KORS, GUS, VFC, PVH)



Euro Confidence Index



Currency Chart the day of RL's earnings release

Basket: Majors | Source: BGN | Last Price | Rate: Spot | Date: 02/04/2014

10) Spot | 11) Forward | 12) Fixing | Heat Map

	USD	EUR	JPY	GBP	CHF	CAD	AUD	NZD	HKD	NOK	KRW
KRW	-.086	-.134	-.737	.041	-.399	.247	1.881	1.870	-.041	-.052	-
NOK	-.034	-.082	-.685	.093	-.347	.299	1.934	1.923	.011	-	.052
HKD	-.045	-.093	-.696	.082	-.358	.289	1.923	1.912	-	-.011	.041
NZD	-1.921	-1.968	-2.559	-1.795	-2.227	-1.593	.011	-	-1.876	-1.887	-1.836
AUD	-1.931	-1.979	-2.570	-1.806	-2.238	-1.604	-	-.011	-1.887	-1.898	-1.847
CAD	-.333	-.381	-.982	-.206	-.644	-	1.630	1.619	-.288	-.299	-.247
CHF	.314	.265	-.340	.442	-	.649	2.289	2.278	.359	.348	.400
GBP	-.127	-.175	-.778	-	-.440	.206	1.840	1.828	-.082	-.093	-.041
JPY	.656	.607	-	.784	.341	.992	2.638	2.627	.701	.690	.743
EUR	.048	-	-.603	.176	-.265	.382	2.018	2.007	.093	.083	.135
USD	-	-.048	-.651	.128	-.313	.334	1.969	1.958	.045	.034	.087

% Change on Day Range
 Below -2.5% | -0.5% to -2.5% | -0.05% to -0.5% | -0.05% to 0.05% | 0.05% to 0.5% | 0.5% to 2.5% | Above 2.5%

Rates are from Composite where Bloomberg BGN is not available

USD to AUS currency

