Coach, Inc.

NYSE:COH

Analyst: Austin Bitzas
Sector: Consumer Disc.

BUY

Price Target: $43

Key Statistics as of 12/9/2016

Market Price:	$38.58
Industry:	Apparel, Accessories & Luxury goods
Market Cap:	$10, 816.5 M
52-Week Range:	$30.06-43.71
Beta:	0.59

Catalysts:

- **Mid-term:** Taking products out of wholesale discount retailers and underperforming North American stores, focusing on high quality retailers
- **Mid to Long-term:** Implementation of a multiyear strategic transformation plan to transform its imagine

Company Description:

Coach, Inc. (NYSE:COH) is one of the most recognized luxury accessories brands pairing exceptional leathers and materials with innovative design in both North America and in targeted international markets. The company designs, produces, and markets these luxury goods, which include handbags, business cases, luggage and travel accessories, men's and women's accessories, gloves, and outwear. Together with a licensing partner Coach also offers watches, footwear, fragrance, and eye wear. Coach works under the Stuart Weitzman brand as well, which is a leader in women's designer footwear. The company is headquartered in New York, New York and was founded in 1941.

Thesis

Coach will begin to experience the positives of its announcement in 2014 of its transformation strategy to create long term shareholder value. Coach's decision to no longer take part in sales through the wholesale channel and limit promotional offers will have short term negative impacts but will return positive results in the long term. This short term negative impact will allow for the price to reach a suitable entry point for investors to capitalize on long term growth creation. Currently, Coach is fairly priced according to conservative estimates which provides the ideal entry point for investors looking for a mid to long term growth stock. An entry point below or at its conservative intrinsic value of about $38 is optimal. Coach is transforming its image from a handbag brand to a lifestyle brand expanding its product line and capitalizing on its luxury image. If Coach is to follow through with its multi-year transformation plan announced it will be able to drive growth in its stock price.

Industry Outlook

The apparel, accessories, and luxury goods has many well established competitors. These competitors which were used in the following evaluation are as follows:

1. Michael Kors, Inc. (NASDAQ:KORS)
2. Kate Spade & Company (NYSE:KATE)
3. Fossil Group Inc. (NASDAQ:FOSL)
4. Ralph Lauren Corp. (NYSE:RL)
5. LVMH Moet Hennessy Louis Vuitton

The luxury goods are considered to be elastic products and will almost always under perform during times of macroeconomic slows. Coach was the leader in accessible luxury hand bags and accessories, which over the past couple years have attracted increased competition. Coach management believe this is due to insufficient context around its brand and not adapting to innovative designs. This has shown with the underperformance of North American sales. To combat this management announced a transformation multiyear growth plan in 2014, which begin implementation in 2015 and expected to see growth starting in 2017 reaching full expectations into 2021.

Management Strategy

Management announced during its earnings call for quarter 4 of fiscal 2016 that it would pull the company's handbags and leather goods out of over 250 locations, which is approximately 25% of department stores. Additionally, management decided on the reduction of markdown allowances. The reasoning behind this is that high promotional discounts are drive customers away from spending more on similar bags at the company's own stores and e-commerce websites. Doing so has negatively impacted Coach's sales by 1.5% for quarter 1 of fiscal 2017. However, sacrificing on short term gains has elevated brand positioning and driven the hand bag average unit retail price to over $300. Pulling products from the whole sale channel has also allowed inventory to reduce as well.

Management also plans on implementing a growth strategy plan to establish its modern luxury concept globally. So far the company has opened and renovated 500 stores globally. These stores have shown higher comparable store growth then other stores and will be used as a growth vehicle long term. As seen in Exhibit 1 management has followed through with its initiative to more internationally with only 30.7% of sales from international operations to 38.3% of sales in 2016.

Exhibit 1:

In Millions of USD except Per Share	FY 2013		FY 2014		FY 2015		FY 2016	
12 Months Ending	06/30/2013		06/28/2014		06/27/2015		07/02/2016	
Revenue	5,075.4	100.0%	4,806.2	100.0%	4,191.6	100.0%	4,491.8	100.0%
North America	3,478.2	69.3%	3,100.5	65.3%	2,467.5	60.3%	2,397.1	53.9%
International	1,540.7	30.7%	1,644.2	34.7%	1,622.0	39.7%	1,704.0	38.3%
Stuart Weitzman	-		-		-		344.7	7.8%
Other	56.5		61.6		102.1		46.0	

Strategy wise Coach is enhancing its brand image from a handbag brand to a lifestyle brand and increasing its voice through expanding its product line of higher quality products. These initiatives are all part of Coach's strategic transformation plan as of 2015.

Competitive Margin Valuation

Exhibit 2:

ROIC/WACC	History	LTM	COR/Revenue	History	LTM
COH	3.24	2.3	COH	29.7%	31.8%
Competitors	1.86	1.74	Competitors	39.0%	39.0%
ROIC	*History*	*LTM*	**Cost of Debt**	*History*	*LTM*
COH	42.0%	20.0%	COH	3.0%	4.4%
Competitors	20.9%	16.5%	Competitors	5.0%	3.4%
WACC	*History*	*LTM*	**Debt to Equity**	*History*	*LTM*
COH	8.6%	8.7%	COH	0.01	0.06
Competitors	10.7%	9.5%	Competitors	0.09	0.11

As seen in Exhibit 2 Coach was compared to its close industry competitors. Coach is outperforming its competitors. Coach's return on invested capital (ROIC) is significantly above its competitors meaning it is efficiently generating returns above its competitors. In may be noticed ROIC has declined nearly half from historic values, which could be as a result of Coach losing its brand image. Management has recognized this issue and is dealing with this through its transformation plan. Further, Coach has a slightly lower risk than its competitors as seen in its weighted average cost of capital (WACC) of 8.7% compared to its competitors' 9.5% for the fiscal year. Moreover, Coach is generating more value than its competitors as illustrated with its ROIC/WACC of 2.30 versus its competitor's average of 1.74. Further, as part of the firm's capital structure cost of debt has risen above Coach's competition most likely due to its recent risk it has taken on by implementation debt. The last metric used was to express Coach's capitalization through its debt to equity ratio. Coach's debt to equity ratio has risen but is still far below that of the levels of its competitors. This indicates Coach has been managing its level of debt it has been using to finance its assets relative to the amount of value represented in shareholder's equity making Coach less risky than its competitors.

Stuart Weitzman Brand

Coach bought The Stuart Weitzman brand in 2015, for $574 million. The brand gives access to high end products such as footwear, jewelry, gloves, scarves and hats. Stuart Weitzman operates over 110 stores in the United States and internally. Coach sees opportunity expanding the brand globally and sees future benefit from Stuart Weitzman's expertise in footwear development as proven leaders in this segment. Performance related to buying this brand has exceeded expectations. The brand contributed to $345 million in revenue in the first year, which is approximately 8% net sales. The brand has begun to be recognized globally. As with the acquiring Stuart Weitzman Coach continues to seek acquisitions to expand its product line as part of its transformation process.

Ownership

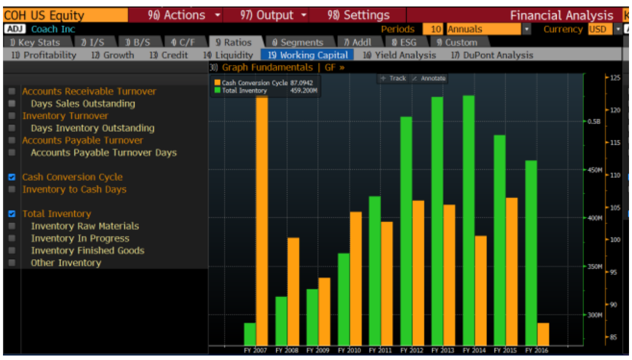
As illustrated in Exhibit 2 Coach's short interest has begun to decline and is at a level of 4.07 from an all-time high of 5.40 in late August. Since mid-October Coach's short interest has begun to decline. This indicates that investors are selling off their short positions, which could indicate that they believe the share price has is no longer over valued and will begin to gain traction once again. Further as illustrated in the bottom of Exhibit 2 average daily trading volume was slightly up from the past few months to 4.45 million. A declining short interest ratio and increase in daily trading volume further supports the claim that Coach is currently fairly priced at about $38.

Exhibit 2:

Financials

The company has also been able to lower its cash conversion cycle as scene in Exhibit 3. This is a positive sign as it implies the company has been able to improve how fast management can turn cash on hand into inventory and accounts payable, through sales and accounts receivable, and then back into cash. Therefore, a low cash conversion cycle ratio implies a healthy company with low liquidity risk. Focus on pulling out of the whole sale channel has been able to decrease total inventory to $459 million from an all-time high of about $526 million. This has helped contribute to the significant decline in cash conversion cycle, which dropped from 106.4 in 2015 to 86.1 in 2016. In comparison to Coach's main competitors Michael Kors, Inc. (NASDAQ: KOR) cash conversion cycle has increased year-over-year and is currently at 105.5, and Kate Spade & Company (NYSE: KATE) cash conversion cycle has risen from 68.9 in 2015 to 88.9 in 2016. This further supports that Coach's strategic plan has contributed to improvements in efficiency.

Exhibit 3:



Valuation

A discounted cash flow model was created based on Coach's financial statements starting as far back a 2005. The financial statements were first adjusted. Assumptions were made based on guidance from Coach's latest 2017 quarter 1 earnings call, and Coach's investor 2014 presentation slides. Then based on historic data and guidance fiscal years 2017 to 2021 were then forecasted to give an intrinsic value for Coach.

The company's earnings call provided short term guidance for fiscal 2017. The guidance is listed as follows:

- Total revenue increase by low-mid single digits
- FOREX increase 1-1.5%
- Operating margins 18.5-19%
- Interest Expense about $25 million
- Tax rate 28%
- Weighted Diluted shares 283 million
- Net income and earnings per diluted share increase by double digit growth
- CAPEX about $325 million
- Diluted EPS $1.83
- Dividends per share $1.3375

The company's 2014 investor presentation slides provided long term guidance estimates as follows:

- Operating margin 20-25% for 2019 and 30% into 2021
- Gross margin stable at 69-70%
- CAPEX about 4-5% for 2019

For the valuation conservative estimates were used. As seen in Exhibit 4 at the end of the write-up a moderate net sales growth of 4% was used to give an intrinsic value of $38.91. However, if Coach were to only have a net sales increase of 3% from 2017 to 2021 it would yield an intrinsic value of $37.22. Further, with a net sales increase of 5% over the next five years Coach has an intrinsic value of $40.66. Therefore, revenue as one can see will play a large roll in to value of the company. An adjustment was made to continue CAPEX as a percent of sales to levels seen historically in 2015. CAPEX rose in 2016 and is expected be $325 million in 2017 because of a change in headquarters. This costed $179.6 million

Summary

Currently, Coach is fairly priced according to conservative estimates, the ideal entry point for investors looking for a mid to long term growth stock would be for when Coach is priced at or below its current price. An entry point below or at its conservative intrinsic value of about $38 is optimal. Coach is transforming its image from a handbag brand to a lifestyle brand expanding its product line and capitalizing on its luxury image in North America and internationally. Coach's transformation process begun in 2015 and will be complete as late as 2021. Management knew that there would be some initial sacrifice for short term gains in order to create long term shareholder value. If Coach is to follow through with its multi-year transformation plan announced it will be able to drive growth in its stock price. With a recent positive rise in revenue growth as Coach has seen negative revenue growth over the past few years among other indicators as mentioned Coach's transformation plan is gaining traction and will experience more positive growth as management anticipated.

Exhibit 4:

Fiscal Year End	**7/2/2017**	**7/2/2018**	**7/2/2019**	**7/2/2020**	**7/2/2021**
Time	0.56	1.56	2.56	3.56	4.56
NOPAT	532.2	597.2	666.6	740.5	819.3
Plus D&A	219.0	227.8	236.9	246.4	256.2
Plus Non Cash Charges					
Plus Change in W/C	11.7	12.1	12.6	13.1	13.7
Plus CAPEX	-325.0	-233.2	-242.5	-252.2	-262.3
FCFF	437.9	604.0	673.6	747.8	826.9
Discounted FCFF	417.5	528.8	541.6	552.0	560.5
Continuing Period FCFF					843.5
Capitalized					12224.0
Terminal Value					8285.2
Value of the Company					10885.6
Plus Cash					859.0
Minus Debt					876.2
Intrinsic Value of the Equity					10868.4
Shares Outstanding					279.3
IV/Share					**$ 38.91**

Today: 12/10/2016

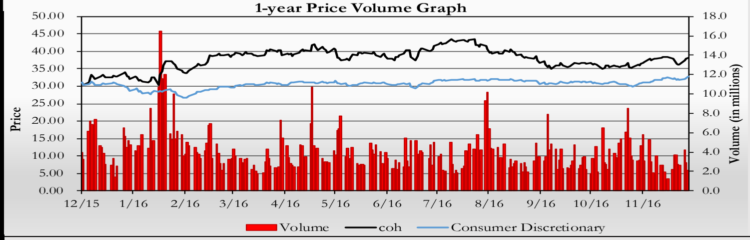
WACC	8.90%	
Terminal Growth Rate	2%	
WACC-g	6.90%	14.49

SIENA college

Siena Market Line
2nd week of December 2016

Analysis by Austin Bitzas	Current Price:	$38.58	Intrinsic Value	$38.85	Target 1 year Return: 13.92%
12/10/2016	Divident Yield:	3.5%	Target Price	$42.61	Probability of Price Increase: 84.4%

1-year Price Volume Graph



Description

Coach, Inc. provides luxury accessories and lifestyle brands.

General Information

Sector	Consumer Discretionary
Industry	Textiles, Apparel and Luxury Goods
Last Guidance	November 3, 2015
Next earnings date	January 31, 2017
Estimated Country Risk Premium	7.50%
Effective Tax rate	28%
Effective Operating Tax rate	26%

Market Data

Market Capitalization	$10,816.49
Daily volume (mil)	1.71
Shares outstanding (mil)	280.37
Diluted shares outstanding (mil)	280.20
% shares held by institutions	90%
% shares held by investments Managers	81%
% shares held by hedge funds	3%
% shares held by insiders	0.18%
Short interest	3.66%
Days to cover short interest	3.69
52 week high	$43.71
52-week low	$29.71
Levered Beta	0.92
Volatility	29.14%

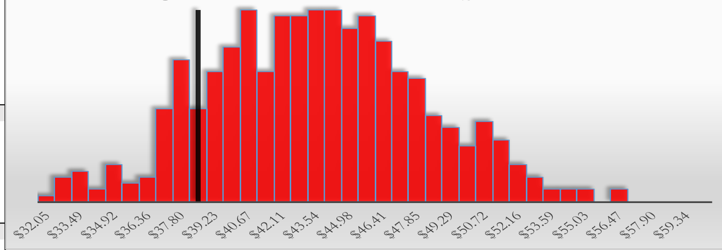
Past Earning Surprises

Quarter ending	Revenue	EBITDA
9/26/2015	-5.04%	-20.04%
12/26/2015	-2.87%	-10.63%
3/26/2016	-1.14%	-15.22%
7/2/2016	-5.44%	-30.08%
10/1/2016	-4.67%	-15.73%
Mean	-3.83%	-18.34%
Standard error	0.8%	3.3%

Peers

Michael Kors Holdings Limited
Under Armour, Inc.
Tiffany & Co.
Urban Outfitters, Inc.
Fossil Group, Inc.
Kate Spade & Company
Ralph Lauren Corporation
PVH Corp.

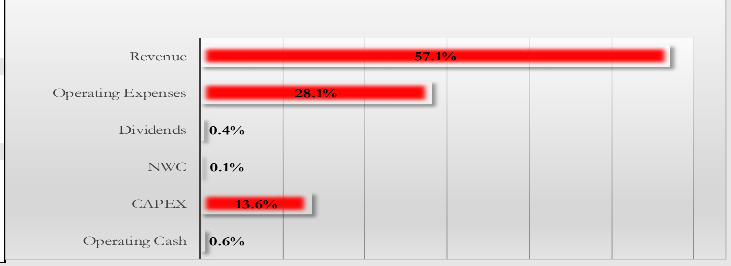
Target Price Distribution--P(price↑)=84.4%



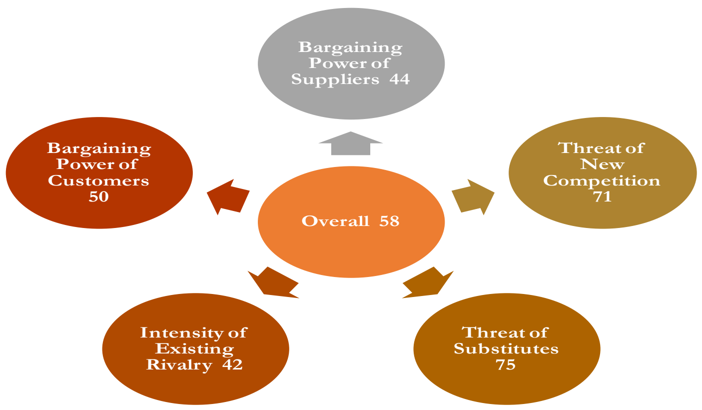
Management	Position	Total compensations growth	Total return to shareholders
Luis, Victor	Chief Executive Officer and	-13.74% per annum over 4y	-10.08% per annum over 4y
Kahn, Todd	President, Chief Administrat	9.62% per annum over 3y	4.22% per annum over 3y
Cohen, Andre	President of North America a	-15.89% per annum over 2y	4.13% per annum over 2y
Bickley, Ian	President of International G	3.6% per annum over 2y	4.13% per annum over 2y
Resnick, Andrea	Interim Chief Financial Offi	N/M	N/M
Brown, Melinda	Principal Accounting Officer	N/M	N/M

Profitability	coh (LTM)	coh (5 years historical average)	Industry (LTM)
ROIC	14.9%	28.57%	15.57%
NOPAT Margin	16%	23.12%	9.6%
Revenue/Invested Capital	0.91	1.24	1.62
ROE	21.8%	35.32%	17.56%
Adjusted net margin	14%	21.53%	8.8%
Revenue/Adjusted Book Value	1.55	1.64	2.00
Invested Funds	**coh (LTM)**	**coh (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	22.8%	21.9%	16%
Estimated Operating Cash/Total Capital	13.6%	14.6%	N/A
Non-cash working Capital/Total Capital	4.1%	3.4%	28%
Invested Capital/Total Capital	77.2%	75.8%	83%
Capital Structure	**coh (LTM)**	**coh (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.29	0.19	0.16
Cost of Existing Debt	4.87%	9.96%	3.92%
Estimated Cost of new Borrowing	5.27%	9.38%	3.92%
CGFS Risk Rating	C	D	CC
Unlevered Beta (LTM)	0.77	1.12	0.61
WACC	9.35%	12.92%	8.40%

Sensitivity Attribution Analysis



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	7.6%	16.4%	1.60
10/1/2017	0.7%	19.0%	1.81
10/1/2018	3.0%	19.0%	1.86
10/1/2019	5.6%	21.9%	2.14
10/1/2020	8.1%	22.7%	2.31
10/1/2021	4.9%	22.5%	2.30
10/1/2022	4.7%	21.7%	2.20
10/1/2023	4.6%	21.0%	2.13
10/1/2024	4.4%	20.3%	2.07
10/1/2025	4.3%	19.7%	2.01
10/1/2026	4.2%	18.9%	1.92
Continuing Period	4.0%	18.2%	1.78

Period	Invested Capital	Net Claims	Price per share
Base Year	$3,335.38	$2,367.91	$38.73
10/1/2017	$3,670.78	$1,757.31	$42.25
10/1/2018	$3,571.52	$1,376.88	$45.88
10/1/2019	$4,709.95	$736.97	$49.71
10/1/2020	$4,928.93	$53.54	$53.65
10/1/2021	$5,185.03	-$577.05	$57.56
10/1/2022	$5,206.51	-$1,279.77	$61.55
10/1/2023	$5,480.60	-$1,969.07	$65.59
10/1/2024	$5,685.44	-$2,616.92	$69.59
10/1/2025	$5,968.45	-$3,185.89	$73.68
10/1/2026	$6,306.71	-$3,800.87	$77.86
Continuing Period			