

March, 24, 2017

Michael Kors Holdings Ltd: KORS

Marion HORRY

Sector: Consumer Goods

Industry: Textile - Apparel Clothing

Current Price: \$37.34

Target Price: \$42.98

The main business of Michael Kors Holding is to design, promote, distribute and retail women apparel, accessories, moreover they are offering apparel for men. Thus, the two customer's targets of Michael Kors are women and men.

To be competitive in the apparel industry Michael Kors is offering high quality products to customers.

In order to provide access to its products to customers they rely on 3 segments: 668 retail stores in 2016, wholesale and 201 licensing stores. In addition, it relies on e-commerce to sales their products.

Actually, the company operates in North America, Europe, Japan, and starts to develop the company in Asia.

BUY

Current Price:	\$37.34
Target Price:	\$42.98
Market Cap:	6.07B
Beta:	-0.44
Volume :	56,310
52 Week Range :	\$34.92 - \$58.63



Thesis:

For the next following year, Michael Kors will ensure revenue growth by expanding their retail store in the Asian market. At the same time, the company will be able to maintain its margin. While increasing revenue and maintaining its margin, Michael Kors should be able to create value and to increase the free cash flow for the following period. Finally, if Michael Kors win the bid of Kate Spread, it will ensure growth in revenue and will reduce the margins. I advise to buy Michael Kors Holding because its stock price is currently undervalued. I expect the price of this stock to rise in the future from \$37.34 and \$42.98.

Catalysts:

Short-term (within a year):

The next earnings report is on April 31, 2017. This can increase the volatility of the stock and help to reach the target price.

Mid-term (1-2 years):

The positive outcome of the acquisition, should increase revenue, and help to increase the margins.

Long-term (+3):

New strategic initiatives taken by Michael Kors Holding will increase revenue, and preserve margins.

New business Plan to achieve long-term growth:

Actually, Michael Kors is generating revenue from 3 segments: retail stores, wholesale and licensing. In 2016, their retail stores were generating 50% of its revenue, wholesales were generated 45.5% and licensing generated 3.7%. The strategic shift of the company is to concentrate their effort on their retail stores. Michael Kors want to improve their retail stores in order to preserve margin and in order to develop more the e-commerce.

Revenue/Total Stores				
	History		LTM	
KORS	\$	7.18	\$	6.93
Competitors	\$	6.09	\$	8.00

Historically, Michael Kors has been able to generate more revenue per store. During the last twelve month, the revenue per stores have decreased and are lower than competitors. By concentrating their effort on its retail stores and thus decreasing their wholesales revenue, the revenue per stores will increase.

The company want to develop and improve its retail stores in the Asian market, because the North American market and the European market are not ensuring growth. European and North American are saturated, thus it is a good opportunity for Michael Kors to develop their brand in Asia. Moreover, Asia market and more particularly the Chinese market will be a good opportunity because there is an increase in GDP per capita. This emphasize the fact that Chinese household will have more purchasing power.

		2014		2015		2016	
		Revenue	% of revenue	Revenue	% of revenue	Revenue	% of revenue
North America	Retail	\$ 1,318.90	39.8%	\$ 1,656.10	37.88%	\$ 1,779.00	37.8%
	Wholesales	\$ 1,335.50	40.3%	\$ 1,662.50	38.0%	\$ 1,628.60	34.6%
	Licensing	\$ 117.40	3.5%	\$ 100.30	2.3%	\$ 99.00	2.1%
Europe	Retail	\$ 235.60	7.1%	\$ 412.10	9.4%	\$ 509.60	10.8%
	Wholesales	\$ 242.00	7.3%	\$ 401.10	9.2%	\$ 406.40	8.6%
	Licensing	\$ 22.90	0.7%	\$ 71.50	1.6%	\$ 74.30	1.6%
Asia	Wholesales	\$ -	0.00%	\$ 1.50	0.03%	\$ 108.90	2.3%
Japan	Retail	\$ 38.50	1.16%	\$ 66.40	1.52%	\$ 106.30	2.3%
Total Revenue		\$ 3,310.80		\$ 4,371.50		\$ 4,712.10	

By implementing its own retail stores in Asia, Michael Kors is taking advantage of a new opportunity. By looking at the wholesales in Asia, it is possible to see the potential growth for Michael Kors. If it succeed well it Asian market penetration, Michael Kors could ensure growth. This growth will offset the stable growth of the North American Market and European market, and it should increase their revenue.

Competitive advantage on margins:

Since Michael Kors plan is to focus more on their own retail stores, we should look at the cost of revenue per stores. Historically, Michael Kors had less cost of revenue per stores compare to its competitors. During the last twelve months, it has been able to still have less cost of revenue per stores compare to its competitors.

COR/Total Stores				
	History		LTM	
KORS	\$	2.88	\$	2.83
Competitors	\$	3.93	\$	4.37

By looking at other expenses per total stores, it is possible to see that historically they had more other operating cost per stores compare to its competitors. For the last twelve months, the other operating expenses per stores increase mainly because of the store pre-opening cost, but its operating expenses are lower than its competitors.

	Other Op. Exp./Total Stores			
	History		LTM	
KORS	\$	2.14	\$	2.28
Competitors	\$	1.24	\$	2.50

By looking at the profitability ratio, it is possible to see that it has a competitive advantage among its competitors.

The gross margin ratio shows that the company is retaining more revenue than its competitors after paying its cost of goods sold. It means that the company retains \$0.5956 for every \$1 generated in revenue.

The profit margin ratio also shows that Michael Kors is more profitable. It means that the company is keeping \$0.2005 for every \$1 of sales. Michael Kors is able to keep more earning than its competitors.

The operating margin ratio shows that the company is able to satisfy its creditors and its shareholders.

The EBITDA margin shows that Michael Kors operates more efficiently than its competitors.

Name	Ticker	GM LF	PM LF	OPM LF	EBITDA Mrgn Adj LF
Median		52.49%	5.71%	8.56%	14.32%
100) MICHAEL KORS HOLDINGS...	KORS US	59.56%	20.05%	25.27%	29.55%
101) RALPH LAUREN CORP	RL US	57.35%	4.78%	7.47%	16.51%
102) HANESBRANDS INC	HBI US	38.86%	9.97%	12.93%	17.77%
103) URBAN OUTFITTERS INC	URBN US	33.04%	6.24%	9.66%	12.13%
104) FOSSIL GROUP INC	FOSL US	50.99%	5.18%	6.90%	10.52%
105) PVH CORP	PVH US	53.99%	4.78%	7.29%	10.19%

Capital Allocation:

The ROIC of Michael Kors shows that it has an efficient way to allocate its capital by choosing profitable investment. Thus, it means that the company is invested money that will later on generates returns. By compare the ROIC of Michael Kors to its competitors, it is possible to see that they are allocating their capital on more profitable investment.

	ROIC (NOPAT/IC)	
	History	LTM
KORS	90.9%	47.3%
Competitors	31.4%	19.7%

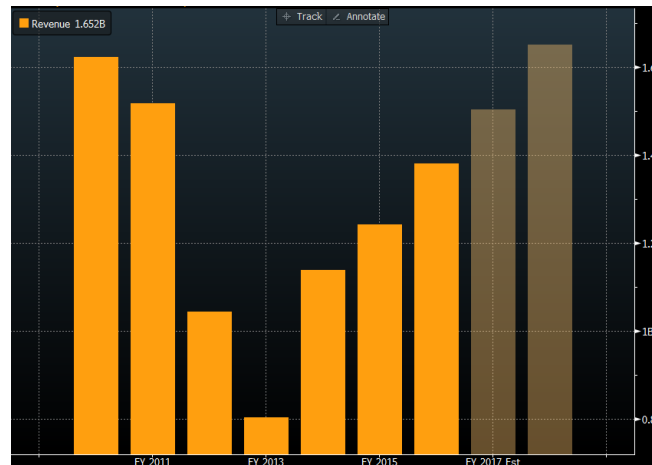
	WACC	
	History	LTM
KORS	10.0%	13.3%
Competitors	9.5%	8.6%

By looking at the WACC, it is possible to notice that Michael Kors has a higher WACC compare to its competitors. Even, if they have a low percentage of debt. Michael Kors has 7.97% of debt to equity ratio. Michael Kors has 47.3% of ROIC and a WACC at 13.3% which means that they are creating value. Finally, Michael Kors is creating \$0.34 for every \$1 invested in capital. Its competitors are creating \$0.111 for every \$1 dollars invested in capital.

Value Creation through Kate Spade Acquisition:

- **Revenue Growth**

Since 2013, Kate Spread is able to increase its revenue. The company should continue to see its sales to grow during the next period because its products have a high demand from customers. The major target customers of Kate Spread are women. They are offering the same type of product such as Michael Kors such as apparel, and accessories. By acquiring Kate Spread, Michael Kors would be able to see a growth in revenue in addition to its growth in revenue from the Asian market.



- **Profitability**

Kate Spread has been able to reach its gross margin close to 59% which is close to Michael Kors's 59.56%. On the opposite side, Michael Kors has been able to maintain its level of gross profit. Through the acquisition, the companies could have a better influence on stakeholders. This will help to ensure the preservation and an increase of the Michael Kors margin. Through, the acquisition, Michael Kors could be able to increase its margin, and thus its will increase their value. Moreover, operating margin should increase by deleting some duplicate departments.

In Millions of USD except Per Share	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
12 Months Ending	12/31/2011	12/29/2012	12/28/2013	01/03/2015	01/02/2016	12/31/2016
Margins						
Gross Margin	53.29	57.42	61.81	59.75	60.68	59.86
EBITDA Margin	-0.68	0.63	7.34	7.72	9.36	16.86
Operating Margin	-6.34	-5.03	2.52	2.94	5.34	13.29

Conclusion:

In conclusion, it is important to notice that Michael Kors will be able to ensure revenue growth while preserving and increasing its margins. Their long term strategy to develop its brand in Asia should help them to gain market share and ensure growth. The possible acquisition of Kate Spread should help them to gain market share and to ensure revenue growth.

Michael Kors Holdings Limited (KORS)
Analyst: Marina HOBBY
3/24/2017

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NEUTRAL

Current Price: \$37.34
Dividend Yield: 0.0%

Intrinsic Value: \$39.16
Target Price: \$42.98

Target 1 year Return: 15.11%
Probability of Price Increase: 96.6%

Description		Market Beta
Michael Kors Holdings Limited engages in the design, marketing, distribution, and retailing of branded women's apparel and accessories, and men's apparel.		0.85
Market Capitalization		\$6,847.43
Daily volume (mil)		1.85
Shares outstanding (mil)		182.44
Diluted shares outstanding (mil)		172.83
X shares held by institutional		37%
X shares held by investment managers		81%
X shares held by hedge funds		5%
X shares held by insiders		4.85%
Short interest		7.33%
Days to cover short interest		4.46
\$2 week high		\$58.63
\$2 week low		\$34.32
Levered Beta		1.63
Volatility		37.81%

Quarter ending	Revenue	EPS	Dividend
12/26/2015	4.83%	2.33X	0.00
9/27/2015	4.85%	4.83X	0.00
7/2/2015	4.91%	12.33X	0.00
10/1/2014	-2.57%	-3.25X	0.00
12/31/2014	-4.84%	-4.35X	0.00
Mean	-1.74%	1.79X	0.00
Standard error	1.4%	2.8X	0.00

Factor	KORS [LTM]	KORS [5 years historical - Industry] [LTM]
ROIC	38.7%	19.35%
NOPAT Margin	32%	8.5%
Revenue/Invested Capital	1.48	1.65
ROE	53.8%	15.84%
Adjusted net margin	24%	7.3%
Revenue/Adjusted Book Value	1.87	2.81

Factor	KORS [LTM]	KORS [5 years historical - Industry] [LTM]
Total Cash/Total Capital	5.3%	22%
Estimated Operating Cash/Total Capital	5.3%	N/A
Noncash working Capital/Total Capital	15.7%	25%
Invested Capital/Total Capital	84.7%	78%

Factor	KORS [LTM]	KORS [5 years historical - Industry] [LTM]
Total Debt/Common Equity [LTM]	0.16	0.16
Cost of Existing Debt	5.31%	5.41%
Estimated Cost of new Debt	5.83%	5.41%
CCPS Risk Rating	D	CC
Unlevered Beta [LTM]	0.65	0.47
WACC	10.55%	8.15%

Period	Revenue growth	Valuation	ROIC/WACC
Base Year	8.7%	22.8X	2.33
12/31/2017	-6.2%	19.8X	1.53
12/31/2018	-1.4%	15.5X	1.85
12/31/2019	4.8%	16.2X	2.88
12/31/2020	4.4%	16.5X	2.84
12/31/2021	4.4%	16.7X	2.85
12/31/2022	4.4%	16.3X	2.86
12/31/2023	4.4%	17.1X	2.86
12/31/2024	4.8%	17.3X	2.87
12/31/2025	4.8%	17.6X	2.88
12/31/2026	4.8%	17.8X	2.88
Continuing Period	4.8%	18.8X	1.63

Period	Invested Capital	Net Claims	Price per share
Base Year	\$81.25	\$1,248.34	\$37.58
12/31/2017	\$1,465.66	\$1,089.36	\$42.18
12/31/2018	\$2,238.44	\$358.72	\$47.44
12/31/2019	\$3,184.14	\$349.42	\$52.34
12/31/2020	\$3,316.25	\$1,824.25	\$58.51
12/31/2021	\$3,162.28	\$1,767.87	\$64.56
12/31/2022	\$3,591.73	\$2,589.35	\$78.58
12/31/2023	\$3,646.53	\$3,278.34	\$75.67
12/31/2024	\$3,778.23	\$4,875.63	\$82.38
12/31/2025	\$3,372.73	\$4,358.87	\$83.23
12/31/2026	\$4,176.84	\$5,823.68	\$55.81