



smartwomansecurities

investment report

Coach (COH)

business overview

Coach, Inc. is a designer, producer and marketer of high-quality, modern American classic handbags and accessories for men and women. Since its founding in 1941, Coach has successfully transformed itself into a branded specialty retailer of handbags, wallets, watches, outerwear, travel, scarves, fine jewelry, office furniture, footwear, and eyewear. Coach is also developing a fragrance line as its first foray into the beauty business. In addition to over 300 US store boutiques, Coach has a multi-channel strategy of selling Coach products in department stores, specialty retailer locations, outlet stores, through the catalogue, and online.

Coach has a global vision, with nearly 200 locations in nineteen countries outside the US. Store locations include Australia, Barbados, Canada, China, France, Guam, Hawaii, Hong Kong, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Saipan, Saudi Arabia, Singapore, St. Marteen, St. Thomas, Taiwan, Thailand, and US Continental. Coach plans to increase international distribution and to target international customers, with an emphasis currently on the Japanese customer. In regard to net sales, at year end Fiscal 2006, the US represented 75%, Japan represented 20% and other international locations, which reflect shipments to third-party distributors primarily in East Asia, represented about 5%.

Coach is currently overseen by Lew Frankfort, the Chief Executive Officer, who has been with Coach for 26 years.

competition

competitor	company description	implications for COH
Kate Spade	Kate Spade, recently purchased by Liz for \$124 million, is a designer that began producing handbags featuring an understated style and simple elegance. Today, their product line has expanded to include luggage, shoe, eye glasses, and paper collections. Kate Spade currently operates stores in New York, Boston, Chicago, San Francisco, Greenwich, Manhasset, Washington DC, Atlanta, Houston, Charlotte, Dallas, and Boca Raton; as well as 8 international flagship	Coach's closest match competition wise because both companies produce a similar array of products and compete for the same area of the market- i.e. gray area between high end luxury lines and less expensive brands.

	stores: four in Japan, three in Hong Kong, and one in the Philippines. It is also sold in Bloomingdales among other retailers.	
Samsonite	Samsonite brand has come to be associated with high quality luggage and accessories. In 2004, Samsonite appointed former Louis Vuitton CEO Quentin Mackay as its Global Creative Director with the goal of blending notable style with the latest design technology. One of the world's most recognized designers and manufacturers of luxury, Samsonite brand also encompasses Timberland and Lacoste	Although currently more readily associated with dependability and technical innovation, Samsonite is branching out into the fashion area of luggage looking to attract a broader customer base. Samsonite is much better established globally than Coach and with the fashion connections of Mackay they could become a big player in fashion luggage and travel accessories one of Coach's main areas.
Tiffany & Co	Originally established as a boutique jeweler in NY in 1837, Tiffany and Co. today includes multiple subsidiaries. The principal subsidiary, Tiffany and Company, is a jeweler and specialty retailer, whose merchandise offerings include an extensive selection of jewelry (82% of net sales in fiscal 2005), as well as timepieces, sterling silverware, china, crystal, stationery, fragrances and accessories. More than 150 TIFFANY & CO. stores and boutiques serve customers in U.S. and international markets.	Competes with Coach's accessory line, watches, and already has a fragrance deal with Estee Lauder (COH is in the process of developing one as well). Very well-known both in US and international markets (38% of 2005 fiscal sales) Also has direct marketing with catalogue. Easily overpowers COH in the accessories, time-piece market but since these, at least currently, are not COH main product lines T&C might not have as much of an impact.

financials from Coach.com

income statement

When looking at Coach's income statement from 2005 to 2006, we can see that operating income increased significantly from \$572,563,000 in 2005 to \$764,604,000 in 2006. Net sales increased by an even greater magnitude than operating income; this can be attributed to the magnitude of the selling, general, and administrative expenses, which increased from 2005 to 2006 and therefore offset some of the increase in net sales.

Additionally, net income has increased from 358,612,000 in 2005 to 494,277,000 in 2006. Net income per share also increased (from \$.92 to \$1.27 diluted). The cost of sales increased in 2006, and this is most likely attributable to the fact that Coach has recently changed the materials it uses to make its products.

CONSOLIDATED STATEMENTS OF INCOME

FISCAL YEAR ENDED ⁽¹⁾ (AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)	JULY 1, 2006	JULY 2, 2005	JULY 3, 2004
Net sales	\$2,111,501	\$1,710,423	\$1,321,106
Cost of sales	472,622	399,652	331,024
Gross profit	<u>1,638,879</u>	<u>1,310,771</u>	<u>990,082</u>
Selling, general and administrative expenses	874,275	738,208	584,778
Operating income	<u>764,604</u>	<u>572,563</u>	<u>405,304</u>
Interest income, net	32,623	15,760	3,192
Income before provision for income taxes and minority interest	<u>797,227</u>	<u>588,323</u>	<u>408,496</u>
Provision for income taxes	302,950	216,070	152,504
Minority interest, net of tax	-	13,641	18,043
Net income	<u>\$ 494,277</u>	<u>\$ 358,612</u>	<u>\$ 237,949</u>
Net income per share			
Basic	<u>\$ 1.30</u>	<u>\$ 0.95</u>	<u>\$ 0.64</u>
Diluted	<u>\$ 1.27</u>	<u>\$ 0.92</u>	<u>\$ 0.62</u>
Shares used in computing net income per share			
Basic	<u>379,635</u>	<u>378,670</u>	<u>372,120</u>
Diluted	<u>388,495</u>	<u>390,191</u>	<u>385,558</u>
<small>(1) Fiscal year ended July 3, 2004 was a 53-week fiscal year</small>			
<small>See accompanying Notes to Consolidated Financial Statements</small>			

balance sheet

Much of Coach's 2005-2006 balance sheet reflects its recent efforts to expand. Cash and cash equivalents have decreased slightly and inventories have increased. The increase in inventories could signal that Coach's products are not selling as well and that they are therefore piling up. However, it seems more likely that the increase in inventories reflects the less troubling possibility that Coach is preparing for the holiday season, in which there is an increase in sales. Also representative of Coach's current expansion is the decrease in retained earnings, which suggests that Coach is investing more of its money instead of keeping it in cash. Also notable is that total assets increased from \$1,370,157,000 in 2005 to \$1,626,520,000 in 2006.

CONSOLIDATED BALANCE SHEETS

(AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)	JULY 1, 2006	JULY 2, 2005
ASSETS		
Cash and cash equivalents	\$ 143,388	\$ 154,566
Short-term investments	394,177	228,485
Trade accounts receivable, less allowances of \$6,000 and \$4,124, respectively	84,361	65,399
Inventories	233,494	184,419
Deferred income taxes	78,019	50,820
Prepaid expenses and other current assets	41,043	25,671
Total current assets	974,482	709,360
Long-term investments	-	122,065
Property and equipment, net	298,531	203,862
Goodwill	227,811	238,711
Indefinite life intangibles	12,007	12,088
Deferred income taxes	84,077	54,545
Other noncurrent assets	29,612	29,526
Total assets	\$1,626,520	\$1,370,157
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	\$ 79,819	\$ 64,985
Accrued liabilities	261,835	188,234
Revolving credit facility	-	12,292
Current portion of long-term debt	170	150
Total current liabilities	341,824	265,661
Deferred income taxes	31,655	4,512
Long-term debt	3,100	3,270
Other liabilities	61,207	40,794
Total liabilities	437,786	314,237
Commitments and contingencies (Note 6)		
Stockholders' equity		
Preferred stock: (authorized 25,000,000 shares; \$0.01 par value) none issued	-	-
Common stock: (authorized 1,000,000,000 shares; \$0.01 par value) issued and outstanding - 369,830,906 and 378,429,710 shares, respectively	3,698	3,784
Additional paid-in-capital	775,209	566,262
Retained earnings	417,087	484,971
Accumulated other comprehensive (loss) income	(7,260)	903
Total stockholders' equity	1,188,734	1,055,920
Total liabilities and stockholders' equity	\$1,626,520	\$1,370,157
See accompanying Notes to Consolidated Financial Statements		

statement of cash flows

Looking at the statement of cash flows, we can see that net cash from operating activities has increased significantly, from \$475,596,000 in 2005 to \$596,603,000 in 2006. By looking at the net cash used in investing activities which decreased in 2006, it seems like investing has decreased, but this is because of an acquisition of a joint venture that took place in 2005. In fact, purchases of investments have increased significantly from \$379,530,000 in 2005 to \$1,195,934,000.

Additionally, we see that cash and cash equivalents have decreased from 2005 to 2006. This is most directly attributable to the increase in the repurchase of common stock, which more than tripled from 2005 to 2006.

investment opportunities

potential for growth in the US

Coach plans to open approximately 100 additional U.S. retail stores over the next three years, increasing its total number of U.S. stores to just over 300. In the long run, Coach envisions operating close to 400 stores in North America. Coach's expansion in the US should enable it to take advantage of favorable consumer trends. The number of handbags bought by the average American woman in one year has doubled to 4 since 2001. At the same time, Coach has been able to expand its market share in the US since 2001 from 17% to approximately 25%.

potential for growth abroad

Coach has begun to expand aggressively into Asia in order to profit from Asia's rapid economic growth and Asian consumers' appetite for foreign luxury goods. Coach currently does 20% of its sales in Japan, benefiting from the fact that Japan and the US together comprise 70% of worldwide luxury spending on handbags. The company plans to expand the number of stores it operates in Japan from 120 to 180, while growing its market share from 9 to 15 percent. Moreover, Coach plans to open up additional stores in Hong Kong, where it currently operates 13 stores, and opening up at least 10 retail stores in mainland China over the next two years. However, Coach's plan is not one of blind expansion. For instance, the company has strategically avoided targeting Europe, where Coach has historically been unable to compete with European luxury brands.

increased focus on customer service

At the same time that Coach is expanding the quantity of its stores, it is also focused on improving the quality of its store by implementing numerous cutting edge customer service initiatives. Over a year ago, Coach began using Client Track to collect information about customer selections and preferences, in order to target customers with applicable emails concerning new products and sales. In addition, Coach is trying out the "Electronic Post-It" in 12 of its stores, which is a handheld device used by salespeople on the floor to let the stockroom know that a customer wishes to purchase an item. The employees in the stockroom can then ensure that the item is waiting for the customer at the register. Finally, Coach also uses more traditional methods of ensuring good customer service, such as only having one of each item on the floor so that each purchase must involve talking with a salesperson, and sending out thank-you notes to customers.

successful appeal to market segment

Coach handbags are successfully priced and marketed to appeal to the “mass affluent” consumer earning more than \$80,000 a year, a demographic that has grown 17% in the past few years to 30 million people. Coach prices its handbags at around \$300 to \$400 per bag, with the higher-end Legacy collection priced around \$800 per bag. These prices make Coach appealing to women who are interested in buying upscale designer handbag from producers such as Louis Vuitton, but also to women who may feel that brands like Louis Vuitton are too far out of their reach.

investment risks

potential for decrease in consumer demand

Coach has developed a strong consumer base that is loyal to its signature style; nevertheless, inherent to the accessory industry is the tough competition that emerges when each label puts out its newest line. Coach is vulnerable to a decrease in consumer demand if it introduces a new line of product that is not as appealing to consumers as the new products of competitors. Coach is particularly vulnerable as it expands overseas, especially in Japan. Expanding very rapidly to foreign markets, Coach may not be as familiar with the preferences of the foreign consumer.

vulnerability to unfavorable market conditions

Since Coach’s products are, for the most part, luxury goods, the company is vulnerable to being negatively affected by negative economic conditions both in the domestic and foreign markets. In poor economic times, people first cut out luxury goods.

business seasonality

A significant portion of Coach’s earnings and cash flow is generated during the holiday season. Since holiday season sales are so important to Coach and there is a lot of competition in the market for luxury goods in this season, the introduction of a weak new line could cost them by leading consumers to turn to competitors.

expansion plan

Though there is great evidence that there is reason to have confidence in Coach’s expansion plan, there are nevertheless inherent risks in expansion. Coach plans to add over 100 stores in North America and 70 more in Japan; it also plans to break into the markets in other Asian countries. Coach has not yet shown that it can manage such volume. The risks involved include the possibility that Coach could sacrifice quality of product and service to accommodate the expansion. Another risk is that while Coach may understand the preferences of the North American consumer, it may not have full awareness of foreign market conditions. Perhaps the Coach name will not carry as much weight abroad as it does in North America.