Tapestry Inc. (TPR)

Updated February 25th, 2019 by Felix Martinez

Key Metrics

Current Price:	$24	**5 Year CAGR Estimate:**	7.2%	**Market Cap:**	$6.96 B
Fair Value Price:	$22	**5 Year Growth Estimate:**	4.5%	**Ex-Dividend Date:**	03/05/20
% Fair Value:	111%	**5 Year Valuation Multiple Estimate:**	-2.0%	**Dividend Payment Date:**	03/30/20
Dividend Yield:	5.5%	**5 Year Price Target**	$27	**Years Of Dividend Growth:**	0
Dividend Risk Score:	D	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

Overview & Current Events

Tapestry Inc. (TPR) was founded in 2017 as a transformation from Coach IP Holdings LLC (founded in 1941) and is a leading American multinational luxury fashion holding company. The company is based in New York and is the parent company of three brands: Coach, Kate Spade, and Stuart Weitzman. The company's renaming came after Coach acquired Stuart Weitzman and Kate Spade and expanded from making Coach-brand handbags to producing a wider variety of products through their three major brands. These products include a variety of leather goods, footwear, accessories, clothes, fragrances, and jewelry. Tapestry has a market capitalization of approximately $6.96 billion, over 20,000 employees, and $6 billion in annual revenue. Coach continues to make up 70% of company sales, Kate Spade represents about a quarter of sales, and Stuart Weitzman is a small but growing segment in the overall business. The company sells products worldwide from its 1,500+ branded retail locations, brand websites, and through thousands of distributor retail locations.

Tapestry reported Fiscal year (FY)2020 second-quarter results on February 6th, 2020, for the period ended December 28th. Sales totaled $1.82 billion for the second quarter as compared to $1.80 billion in the prior year, an increase of 1%. The company earned $1.08 a share, or an increase of 22.7% compared to $0.88 a share that was earned in 2Q19. However, for the first half of FY2020, EPS came in at $1.13 vs. $1.29 in the first half of FY2019, or a decrease of (12)%.

Management's outlook for 2020 is for revenue to decrease because of the coronavirus outbreak in China. A negative impact of approximately $200-$250 million in sales and $0.35-$0.45 in diluted earnings. Thus, the company expects revenues for FY2020 to be about $5.9 billion and EPS of $2.15 - $2.25. We will use the midpoint of $2.20 for our valuation calculation.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.33	$2.92	$3.53	$3.72	$3.10	$1.92	$1.98	$2.15	$2.63	$2.57	***$2.20***	***$2.74***
DPS	$0.38	$0.68	$0.98	$1.24	$1.35	$1.35	$1.35	$1.35	$1.35	$1.35	***$1.42***	***$1.42***
Shares[1]	298.9	255.5	285.1	281.9	274.4	276.6	278.5	281.9	288.0	286.8	***270.0***	***270.0***

Tapestry had experienced negative earnings growth of (5.98)% since 2013, when it earned $3.72 per share, but has had 2.8% annual growth over the past five years. Revenue has continued to grow at a CAGR of 9.5% for the past five years, while operating margins have deteriorated, resulting in flat and choppy earnings in recent years. We expect stabilization and 4.5% forward earnings growth, due primarily to share buybacks at low valuations along with continued slow revenue growth, but the outcome is highly dependent on Tapestry's ability to maintain margins and sustain at least mild topline growth.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.2	17.3	18.4	14.9	16.2	19.4	17.4	18.3	17.4	15.2	***11.1***	***10.00***
Avg. Yld.	1.1%	1.3%	1.5%	2.2%	2.7%	3.6%	3.9%	3.4%	3.0%	3.5%	***5.5%***	***5.2%***

[1] Share count is in millions.

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Over the past decade, Tapestry has averaged a P/E ratio of 17.0. However, for most of that period, the company consisted entirely of the Coach brand and enjoyed higher returns on invested capital. With slowing sales and declining margins in a competitive environment of online competition and slower global growth, we consider a P/E ratio of 10 to be fair until the company can demonstrate a resumption of growth and stabilized margins. The company has considerable upside valuation potential even with a partial reversion towards the mean of a P/E ratio of 12 or 13, but likely only if the company demonstrates improvement.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2024
Payout	16.3%	23.3%	27.8%	33.3%	43.5%	70.3%	68.2%	62.8%	51.3%	52.5%	***65%***	***52%***

Tapestry's luxury brands, especially Coach, give the company at least a small economic moat. This is evidenced by the company's historically high returns on invested capital and considerable market outperformance since Coach went public in the early 2000s. However, the company's returns on invested capital have been declining in recent years, which may indicate a deterioration in brand strength or could be cyclical in nature as online retail puts margin pressure on all physical retailers. Overall, their investment returns and profitability remain above average but diminishing. The ongoing trade dispute between the United States and China puts further pressure on Tapestry, as a small portion of its products are made in China, but a significant portion of its sales are earned from China.

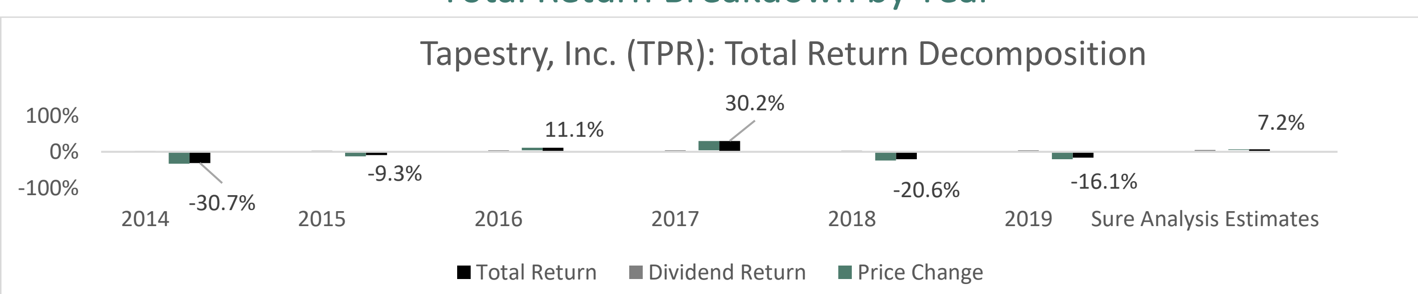
Tapestry currently has a BBB- credit rating, which puts them on the low side of investment grade. However, the company has net debt (cash equivalents minus total debt) equal to less than one year's worth of net income, which is quite strong. The company's balance sheet strength is very high, with a Debt/Equity ratio of 0.37. Still, the inconsistency of their earnings and economic vulnerability of the company appear to be driving lower overall credit quality from the rating agencies.

The company pays a large but flat dividend, which is not a sign of strength. The company may be useful for current income with a high yield and reasonable payout ratio. Still, the security does not necessarily offer growth or stability that many retirees rely on. The company did remain highly profitable during the previous two recessions as the primary Coach brand, but the expanded Tapestry company is untested by a recession in its current form.

Final Thoughts & Recommendation

Tapestry has decent brands but is facing stiff competition, global tariff uncertainty, coronavirus outbreak in China, and diminishing profitability along with the rest of the retail sector. The good news is that Tapestry is a producer of its products, rather than just a middleman, and has various online platforms from which to grow. We expect moderate forward returns of 7.2% per annum from Tapestry as a baseline case, but the result is expected to be highly variable. The dividend yield is high and well covered by earnings, but the dividend is flat, and overall business uncertainty remains high. We consider Tapestry to be a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	3608	4159	4763	5075	4806	4192	4492	4488	5880	6027
Gross Profit	2634	3024	3466	3698	3297	2909	3051	3081	3849	4054
Gross Margin	73.0%	72.7%	72.8%	72.9%	68.6%	69.4%	67.9%	68.6%	65.5%	67.3%
SG&A Exp.	1484	1719	1954	2174	2177	2291	2398	2294	3178	3240
D&A Exp.	127	125	133	163	189	192	211	213	260	268
Operating Profit	1150	1305	1512	1525	1120	618	654	787	671	814
Operating Margin	31.9%	31.4%	31.7%	30.0%	23.3%	14.7%	14.5%	17.5%	11.4%	13.5%
Net Profit	735	881	1039	1034	781	402	461	591	398	643
Net Margin	20.4%	21.2%	21.8%	20.4%	16.3%	9.6%	10.3%	13.2%	6.8%	10.7%
Free Cash Flow	910	886	1037	1173	766	728	353	571	729	518
Income Tax	423	420	467	486	341	209	166	168	199	123

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	2467	2635	3104	3532	3663	4667	4893	5832	6678	6877
Cash & Equivalents	596	700	917	1063	592	1292	859	2673	1243	969
Accounts Receivable	109	143	174	175	199	220	245	268	314	298
Inventories	363	422	504	525	526	485	459	470	674	778
Goodwill & Int. Ass.	316	341	386	355	371	794	849	821	3217	3228
Total Liabilities	962	1023	1111	1123	1243	2177	2210	2830	3434	3364
Accounts Payable	106	119	155	179	154	223	187	195	264	244
Long-Term Debt	25	24	23	1	141	890	876	1580	1594	1597
Shareholder’s Equity	1505	1613	1993	2409	2421	2490	2683	3002	3245	3513
D/E Ratio	0.02	0.02	0.01	0.00	0.06	0.36	0.33	0.53	0.49	0.45

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	29.2%	34.5%	36.2%	31.2%	21.7%	9.7%	9.6%	11.0%	6.4%	9.5%
Return on Equity	45.9%	56.5%	57.6%	47.0%	32.4%	16.4%	17.8%	20.8%	12.7%	19.0%
ROIC	45.1%	55.6%	56.9%	46.7%	31.4%	13.5%	13.3%	14.5%	8.4%	12.9%
Shares Out.	296.9	288.5	285.1	281.9	274.4	276.6	278.5	281.9	288.0	286.8
Revenue/Share	11.42	13.79	16.19	17.73	17.14	15.12	16.08	15.87	20.37	20.73
FCF/Share	2.88	2.94	3.53	4.10	2.73	2.62	1.26	2.02	2.53	1.78

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.