

WESTPEAK RESEARCH ASSOCIATION

Fossil Group Inc. (NASDAQ: FOSL)

Consumer Discretionary – Clothing & Accessories

Out with the Old, In with the New

January 4, 2019

Fossil Group Inc. ("Fossil") is a global design, marketing, and distribution company that offers men's and women's watches and jewelry, handbags and leather goods, and sunglasses; operating primarily in the Americas, Europe, and Asia. Fossil has also developed, acquired, or licensed many recognized brand names.

Traditional Watch Declines and Smartwatch Adoption

Fossil has seen declining growth in its traditional watch segment for the last couple years, and growth in its smartwatch segment has thus far been overshadowed. The company's connected watch portfolio shows strong potential for profitability, specifically its position in the hybrid watch market. However, due to the decline in traditional watches sales, we feel that investors should be cautious of the negative impact that the traditional watch segment continues to have on the company.

Valuation

Fossil's current share price is \$16.50, which we believe to be fairly valued. We used a discounted cash flow analysis and comparable company analysis weighted at 50% each to determine a target share price of \$18.00 representing a 7.0% total return. Given this valuation, we recommend a **Hold** rating for Fossil Group.

Analyst: Ali Cervienka, BCom. '21
contact@westpeakresearch.com

Equity Research U.S.

Price Target	USD\$ 18.00
Rating	Hold
Share Price (Jan. 4 Close)	USD\$ 16.50
Total Return	7.0%

Key Statistics

52 Week H/L	\$32.17/\$7.16
Market Capitalization	\$816M
Average Daily Trading Volume	\$1.63M
Net Debt	\$397M
Enterprise Value	\$967M
Net Debt/EBITDA	3.61x
Diluted Shares Outstanding	\$49M
Free Float	92.0%
Dividend Yield	n/a

WestPeak's Forecast

	2017A	2018A	2019E
Revenue	\$2.79B	\$2.54B	\$2.42B
EBITDA	\$112M	\$183M	\$170M
Net Income	(474)M	\$(0.9)M	\$23M
EPS	\$(9.87)	\$(0.07)	\$(0.47)
P/E	N/A	N/A	35.8x
EV/EBITDA	8.9x	5.4x	5.9x

1-Year Price Performance



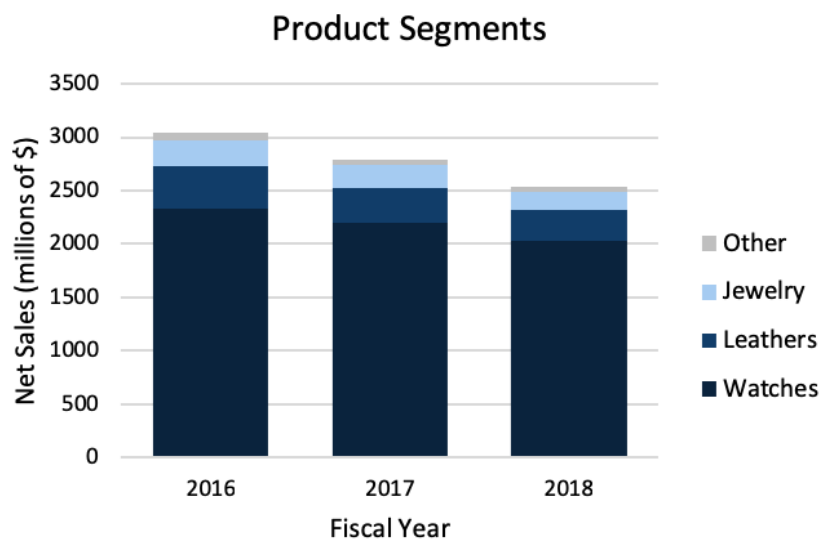
Business Overview/Fundamentals

Company

Fossil Group Inc. is a global consumer fashion accessories company that designs, markets, and distributes a variety of men's and women's watches, jewelry, handbags, leather goods, and other accessories. Additionally, Fossil has helped develop, license, and acquire, many well-known brand names including Michael Kors, Armani Exchange, Chaps by Ralph Lauren, Diesel, and Emporio Armani. Fossil's products are currently available in 150 countries and are distributed through wholesale, retail, and commercial website channels. In 2018, approximately 49% of watches were globally produced through fully or majority-owned factories. This vertically-integrated structure gives Fossil a competitive advantage over its competitors for licensed brand agreements, as they are able to launch or increase a product category globally in an integrated manner.

Products

Fossil segments its products into three categories: watches, leathers, and jewelry. The watch segment claimed approximately 80% of revenue in 2018, and the company remains focused on continuing to develop this product category. As a leader in the multi-segment watch category, Fossil defines its watches as either traditional or connected. Traditional watches typically utilize either mechanical or quartz-analog movement to keep time, while connected watches have imbedded technology with additional features, including touchscreen, heartrate tracking, and GPS. Fossil's connected accessory, or wearable technology, segment accounted for approximately 11% of net sales in 2017.



Source: FY2018 and FY2017 Company Filings

Wearable Technology

Fossil's wearables segment accounted for 18% of total watch sales in the third quarter of 2018, a 3% increase from the previous year. Growth in this segment increased by 30% in Q3 of 2018. The company first entered the wearable technology market in 2016 when it launched 40 new smartwatch hybrids across its accessory brands. Hybrid watches are intended to maintain the classic aesthetic of a traditional watch, while providing added features of a connected watch. They are lithium

battery-powered, and similar to a traditional watch, you do not have to charge them regularly, only replace the battery every 4-6 months. Unlike a regular smartwatch which has to be charged approximately every 24 hours. However, hybrid watches still connect to your phone, allowing you to receive texts, calls, and social media notifications. As a newly emerging market, Fossil's hybrid watches face few competitors, specifically Withings, Samsung, and Movado. Fossil recently partnered with Citizen to expand this category and continue to innovate new products.



Source: Fossil.com

In August 2017, Fossil announced a massive expansion of its wearables segment, partnering with Google and their Android Wear technology to power its new fashion-first touchscreen smartwatches. These connected products are able to measure heartrate, receive notifications, execute mobile payment, track exercise, and more. By the end of 2017, Fossil had launched 300 connected watch styles across 14 of its brands. Although sales in the connected segment increased in 2018, this growth was more than offset by the decline in traditional watch sales. Throughout 2018, Fossil leveraged its increasing sales volume in its wearables segment to reduce costs and innovate new features for its products.

Traditional Watches

Although, traditional watch categories have experienced volatility over the past 5 years, Fossil continues its attempts to grow this segment through the innovation of styles, new product drop strategies, and the introduction of both proprietary and licensed brands.

Fossil competes in all price segments of the traditional watch industry, from mass-market to luxury. The majority of Fossil's owned and licensed brand names compete in the designer, mid-range, and mass market segments. In terms of geographical segments, Fossil's traditional watch segment drove declines in the company's total watch portfolio in the Americas and Asia, with a slight increase in Europe. This being said, specific brands have performed better in some locations than others. For example, Emporio Armani traditional watches showed strong performance in Asia in 2017, which was ultimately offset by the declines in other brands.



Source: Fossil.com

Fashion Accessories

In addition to watches, Fossil also sells a range of fashion accessories including small leather goods, handbags, belts, and jewelry. The company sells these products under many of its proprietary and licensed brands including Fossil, Relic, Diesel, Emporio Armani, and Michael Kors. Fossil's competitors in the fashion accessories market include Coach, Guess?, Kenneth Cole, and Nine West. Sales in the fashion accessory segment accounted for 18.4% of Fossil's net sales in 2018, 19.7% in 2017, and 21.6% in 2016.



Source: Fossil.com

Brands

Fossil develops, acquires, or licenses other globally recognized brand names in the watch and accessory segments. Sales of licensed watch brands made up 46.6% of total company net sales in 2018. These brands include Armani Exchange, Diesel, DKNY, Emporio Armani, and Michael Kors. Fossil is able to leverage its brands to offer a variety of price points in each of its product categories. Additionally, it utilizes these price points to determine a strategic brand or product mix in each of its geographical segments. For example, the company's watch sales mix in their Europe and Asia segments are comprised more predominantly of licensed brands with higher price points.

Michael Kors products, including watches and jewelry, accounted for 22.6% of net sales for 2018. Products under the Armani brand name accounted for 14.7% of total net sale in 2018. In April 2018, Fossil announced a partnership agreement with PUMA for the production of watches and smartwatches planned to be released in 2019. In July, BMW and Fossil announced a similar agreement for BMW branded watches and smartwatches, also expected to be introduced in 2019.

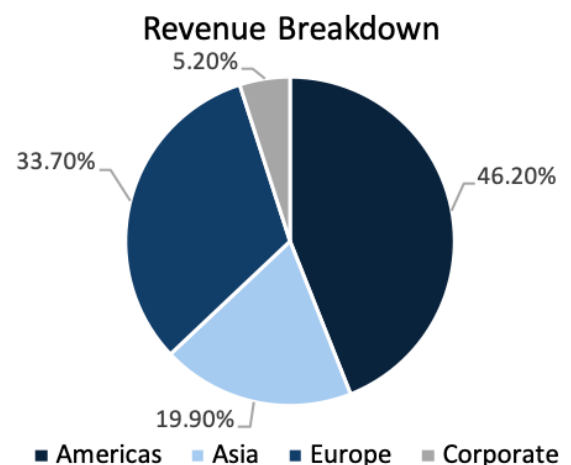
Fossil's most recent brand deal was in October 2018; a strategic partnership with CITIZEN Watch Company to expand the hybrid smartwatch market and collaborate in future innovation of this product category. Fossil will be supplying Citizen with its hybrid watch technology to use in products under its own brand and to distribute to third-party watch brands. This is a promising opportunity for Fossil, given that it is a leader in the hybrid watch market and can leverage its technology to build even more growth in this segment.

Sales in the third quarter of 2018 were negatively impacted by the exit of two of Fossil's licensed brands, Adidas and Burberry. However, we see Fossil's new agreements with PUMA, BMW, and Citizen to positively impact the growth in its watch segment as these company's all have significant customer followings. They will also expose Fossil to new consumer segments, providing a unique opportunity, as PUMA and BMW cater to completely different audiences than existing brands.

Distribution

Fossil primarily operates in three geographic locations: Americas, Europe, and Asia. It has a large range of distribution channels through which it offers its products, including physical retail stores, airlines, and e-commerce sites. Fossil's major wholesaling customers include Amazon, Best Buy, Dillard's and JCPenney.

Proprietary Watch Brands	Retail Price Point Range
Fossil	\$85 - 295
Michele	\$345 - 5,995
Misfit	\$60 - 220
Relic	\$45 - 150
Skagen	\$95 - 295
Zodiac	\$595 - 1,000
Licensed Watch Brands	Retail Price Point Range
Armani Exchange	\$100 - 295
Diesel	\$75 - 195
DKNY	\$100 - 495
Emporio Armani	\$175 - 2,995
Karl Lagerfeld	\$125 - 300
Kate Spade New York	\$150 - 350
Marc Jacobs	\$150 - 300
Michael Kors	\$195 - 550
Tory Burch	\$195 - 395



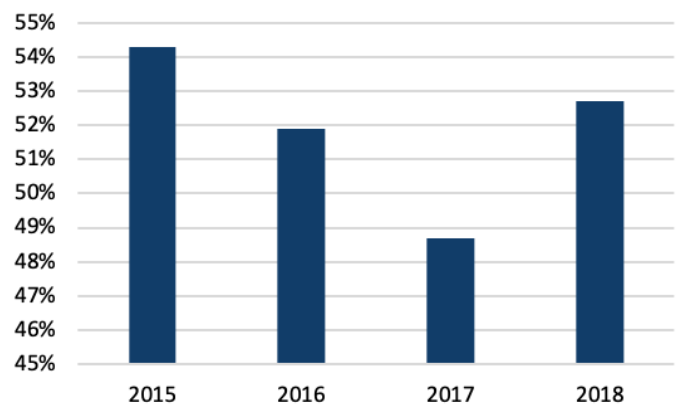
Company Strategy

Management has outlined four overarching objectives to drive their current initiatives: improve profitability, innovate product offering, expand e-commerce and digital marketing, and transform business model. To achieve these goals, the company launched New World Fossil initiative in 2016, a multi-year restructuring program, to improve operating profit and support sales growth with a smaller infrastructure and improved business model. Fossil has been working to create greater efficiencies by refining its product range, optimizing its cost structure, merging facilities, and other operational shifts.

Improve Profitability

With the disruption in traditional retail by e-commerce, Fossil is focused on achieving a smaller physical retail footprint, while becoming a more profitable company. Company restructurings including store closures, business exits, and license expiries, negatively impacted sales performance in 2018. The growth in the connected watch market has ultimately been offset by the decline in the traditional watch market. Fossil expects this to be the case for the short term. However, they continue to forecast savings from gross margin expansion and operational efficiencies, approximately \$200 million by the end of 2019. From the New World Fossil initiative, the company generated \$80 million of benefits in 2017, and projected another \$60 million for 2018. Additionally, product costs for connected products decreased by 20% from 2016 to 2017, which has contributed to the company's profitability.

Gross Profit Margin



Source: FY2018, FY2017, and FY2016 Company Filings

Innovate Product Offering

As the watch market continues to evolve rapidly, Fossil has positioned itself to compete in the connected and hybrid watch categories. The company released two new Gen 4 display watch platforms for the 2018 holiday season in the third quarter. In November, they launched their newest smartwatch with the Qualcomm Snapdragon Wear 3100 Platform and redesigned Google Wear operating system. Fossil's partnerships with Qualcomm and Google will continue to drive innovation in the wearables market, by allowing Fossil to merge function with fashion. As mentioned previously, the company recently partnered with Citizen to bring awareness to the hybrid watch market, as this makes up approximately 14% of the smartwatch market.

Expand E-Commerce and Digital Marketing

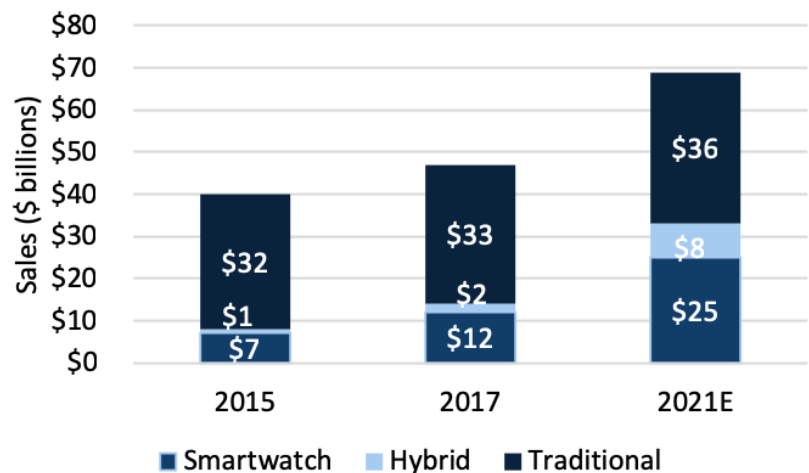
Since focusing on the improvement of e-commerce channels and digital marketing tactics, Fossil has seen positive results in its Fossil brand core sales and overall consumer engagement. In the third quarter of 2018, sales on the company's owned

e-commerce sites grew by 15%, with increases in all geographical segments. The use of social media influencers, celebrity sponsorships, and online ambassadors have helped drive e-commerce spending. The third quarter of 2018 saw a 20% increase in global digital media spending for the Fossil brand, contributing to the 5% total sales growth in its direct channels.

Transform Business Model

Under the New World Fossil initiative, the company is working to transform its business model to match changing consumer preferences. This new business model is focused on integrating operational efficiencies, streamlining production, improving margins, and ultimately enhancing the bottom line. Management plans to execute these strategies by pursuing opportunities in distribution channels, sourcing, and revenue optimization. Part of the company's operating income improvements will come from exiting unprofitable stores and product lines. The reduction of operating expenses in 2018 were a result of lower store expenses, lower variable marketing expenses, and corporate and regional infrastructure reductions. Management has confirmed that the company remains on track with the program's objectives. This program is expected to drive \$200 million in gross margin and efficiency benefits by the end of 2019.

Retail Sales of Global Watches Below \$1,000



Source: Fossil Investor Presentation 2018

Industry Analysis

Smartwatch Industry

Since the introduction of the first Apple Watch in 2015, smartwatches have disrupted the traditional watch industry. Apple was able to leverage the popularity of its other touchscreen devices to provide customers with an additional accessory to connect with their existing Apple devices. The growth in the connected watch segment is significantly attributed to our increasingly connected lifestyles, growth in the health and fitness industry, and the evolution of technology as a whole. Watch consumers are now looking for more out of their devices, rather than solely time-keeping abilities.

The wearable technology industry, which includes both hybrid and display watches, is currently a \$14B market and is expected to reach \$33B by 2021. This represents a 10% growth for the watch market as a whole, including the projected \$36B traditional watch market in 2021. Although this industry's growth will continue globally, US and China have significantly larger markets for these products. Major players in this industry include Apple, Fitbit, Samsung, Garmin, Huawei, Lenovo, and LG Electronics. In relation to its competitors, Fossil's connected watches are keeping up with the latest features and watch technology. As seen in the comparative graphic, Fossil's newest smartwatch is in line with its mid-market competitors in terms of technology and price point.

Fossil has a growth opportunity in the hybrid watch market, being one of few players in this product category. This market is expected to reach \$8B by 2021, representing a significant increase from the \$2B valuation in 2017. We believe this poses an opportunity for Fossil to combat its declining traditional watch segment and utilize its technology partnerships in the smartwatch space. Moreover, Fossil made a deal with Google in January 2019 to sell its intellectual property related to a smartwatch technology currently being developed for \$40 million. This will allow Fossil to leverage its technological advantage in the smart watch space and continue its innovative partnership with Google.

	Gen 4 (Falcon/ Raven)	Apple Series 3	Apple Series 3 LTE	Samsung Gear s3	Fitbit Ionic	Fitbit Versa	Garmin fenix 5
Pricing	\$255+	\$329	\$399	\$349	\$299.95	\$199.95	\$549.99
OS	Wear OS by Google	watchOS	watchOS	Tizen OS	Fitbit OS	Fitbit OS	Garmin OS
Case Size	41mm - 48mm, 11- 12mm thick	38mm, 11mm thick 42mm, 11mm thick	38mm, 11mm thick 42mm, 11mm thick	46x49mm, 13mm thick		42mm, 13 mm thick	42mm, 15mm thick 47mm, 15.5mm thick 51mm, 18mm thick
Display	1.2", 390 x 390 1.4" 454 x 454	38mm: 272x340 42mm: 312x390	38mm: 272x340 42mm: 312x390	1.3", 360x360	1.4", 348x250	1.2", 390 x 390	1.1", 218 x 218 1.2", 240 x 240
Battery Life	24 hrs	18 hrs	18 hrs	3-4 days	4 days	2 days	No GPS: 2 weeks GPS/HR: 24 hrs
Heart Rate	✓	✓	✓	✓	✓	✓	✓
GPS	✓	✓	✓	✓	✓	✓ (Tether.)	✓
NFC	✓	✓	✓	✓	✓	✓	
Swimproof	✓	✓	✓		✓	✓	✓
Speaker		✓	✓	✓			
Cellular			✓	✓			

Source: Fossil Investor Presentation 2018

Traditional Watch Industry

The smartwatch market has greatly impacted traditional watch popularity and overall revenue growth, with an overall estimated decrease of 13.4% in 2018. In 2017, Apple announced that it sells more Apple Watches than the entire Swiss watch industry combined. This spontaneous growth has ultimately disrupted the traditional watch industry by shifting consumer preferences. In turn, traditional watches have become more of a fashion accessory bought primarily for aesthetic value, rather than for functionality.

Traditional watches can be broken down into four segments. The first segment includes luxury watches made with rare or precious materials, primarily produced in Switzerland. Brands that compete in this market are Swatch, Patek, Cartier, Omega, Rolex, and select limited edition pieces in Fossil's Michele line. These watches typically range from \$4,000 to \$20,000 in value. Rolex and Patek Phillipe together hold a 70% share of the US market for watches \$10,000 and up, making

Fossil a small player in this price range. The top three markets for Swiss watch exports in the first half of 2018 were Hong Kong, USA, and China, with annual growth of 29.5%, 9.1%, and 13.4% respectively. This segment has thus far survived the technological disruption of smartwatches due to the irreplaceable consumer taste for luxury, high-end goods, and is expected to continue a rebound in the next 5 years.

The second traditional watch segment includes brand such as Gucci, Movado, Raymond Weil, Seiko, and Tissot, characterized as designer watches produced in Switzerland and Asia. Fossil competes in this segment with its Armani, Michele, and Zodiac brands. The retail prices of these watches typically range from \$500 to \$4,000. Although this market is not as strong as the luxury market in the US, Fossil holds an advantage in this segment due to the fact that its brand is more well-known in the US than mid-priced Swiss brands.

Mid-priced watches from brands such as Anne Klein, Guess?, Kenneth Cole, Swatch, and many of Fossil's main brands make up the third segment of traditional watches. Typically sold through department stores or specialty stores, these watches range from \$60 to \$1,000 in value. They are primarily produced in China or Hong Kong. This segment directly competes with the wearables market, as price ranges are similar with the best-selling smartwatches.

Lastly, mass produced watches, that are primarily manufactured in Asia, make up the fourth segment with brands such as Armitron, Casio and Timex. Fossil competes in this segment through private label watch products for Kmart, Target, and Walmart. These watches typically range from \$7 to \$60.

Catalysts

Hybrid Watch Adoption

Fossil holds a strategic position in the hybrid watch market to combat the falling popularity of mid-range traditional watches. Currently a \$2B market, the global hybrid watch market is expected to reach \$8B by 2021. Fossil has the opportunity to leverage its brand image and history in the traditional watch market to gain rapid adoption of its hybrid watches. With luxury watches on the rebound, consumers are still searching for classic timepieces. However, with this segment being dominated by Swiss luxury and high-end brands, Fossil must develop a competitive edge. Fossil is already a leader in the hybrid watch industry, with few close competitors, and can utilize its partnerships with Citizen and Google to grow this product category. Fossil's strong brand image and technological advantage has the potential to drive the adoption of hybrid watches. Much like the disruption of smartwatches in the traditional watch market, we believe that hybrid watches have the potential to take the place of traditional watches in the long term.

Potential Acquisitions

As a fairly mature company, Fossil stands in a position to possibly be acquired by one of its competitors. From a financial point of view, Fossil owes a reasonable amount of debt valued in the third quarter of 2018 at \$397M. Additionally, the company holds \$238M in cash with an enterprise value of \$967M. Many of Fossil's peers hold much higher values, and therefore would be in a position to acquire a company like Fossil. We believe Fossil is an attractive acquisition for companies in the watch industry due to its extensive portfolio of proprietary and licensed brands, strong brand image, technology ownership, and vertical integration. In January of 2018, Fossil sold a piece of its intellectual property to Google for its

smartwatch technology. Moreover, the company continues to decrease its holdings of physical assets and shows profitable opportunities in its e-commerce channels. We believe that these both prove the value of the company as a potential acquisition and strategic investment in the rapidly growing smartwatch industry.

Management Team

Kosta N. Kartsotis – Chief Executive Officer

Having been with Fossil for 30 years, and served as its CEO for 18 years, Kosta N. Kartsotis has shown commitment to the company and its many transitions. Kartsotis began as Fossil's Vice President of Marketing in 1988, transitioned to President and Chief Operating Officer in 1991, and was appointed Chief Executive Officer in 2000. As of December 30, 2017, Kartsotis owns approximately 3.37M shares, or 6.79% of the company's outstanding common stock.

Jeffrey Boyer – Chief Financial Officer

Jeffrey Boyer has been on Fossil's Board of Directors since 2007, and currently serves as Chairman of the Company's Finance Committee. He was recently appointed to Executive Vice President, Chief Financial Officer, and Treasurer in October 2017. Jeffrey Boyer has held the position of Executive Vice President and CFO at Pier 1 Imports since 2015, and has previously served at Tuesday Morning Corporation and 24 Hour Fitness Worldwide.

Management Conclusion

With Kartsotis' history with the company and Boyer's extensive financial background, we believe that management has the ability to achieve the company's long-term goals. Based on Kartsotis' commitment and monetary investment in the company, we trust that his values are aligned with the company's as a whole. Boyer provides the company with financial experience in the retail sector, and although he was only recently appointed to the position of CFO, we believe he will be an effective leader of the company's financial well-being going forward.

Shareholder Base and Liquidity

Shareholder Base

As of the third quarter of 2018, Fossil has 49,455,528 common shares outstanding, with 155%% of those shares owned by institutional investors and 10% owned by insiders. The reason that there is over 100% of outstanding shares owned by investors is because of the short interest on the stock, which causes there to be multiple claims of ownership on these shares.

Liquidity

The average trading volume for FOSL over the last 3 months is 1.63M shares. As of December 2018, the short interest on the company was 13.72M, which makes up 30.99% of the float. Because there is such a high percentage of short interest, this explains why the amount of institutional holdings exceed 100% of shares outstanding.

Valuation

Discounted Cash Flow Analysis Assumptions

Stores: Because Fossil is in the midst of a restructuring program, we based the amount of store openings and store closures on management's expectations for 2018. They predicted approximately 30 stores would be closed in 2019, with 10 store openings. For the next five years, because Fossil is moving into the second phase of its restructuring program, we assumed that there will be less store closures. As for the opening of new stores, we predicted that only 10 stores would open each year, due to the fact that the company is putting more focus on its e-commerce space.

Revenue: We based revenue assumptions on revenue per store, while following the company's historical trend for its segmented revenue mix. The percentage of watch revenue has gradually increased over the last five years, and we assume this will continue as Fossil exits unprofitable businesses in the leather and jewelry segments. Revenue per store has gradually been declining for Fossil based on historical data, so we decided to gradually increase annual revenue per store due to the fact that they are continuing to close stores.

SG&A + COGS: We based FY2019 predictions for SG&A and COGS on management's expectations for the year. As for the future, part of the New World Fossil initiative is to improve gross profit and expand operating margins by cutting store expenses, marketing expenses, and exiting unprofitable store locations and business segments. Therefore, we adjusted COGS expenditure accordingly to gradually increase this ratio over the next five years as we believe that the company has a strong strategy in place to achieve this. As for the SG&A margin, we followed Fossil's historical trend, which has been gradually increasing for the past 5 years.

Effective Tax Rate: For our effective tax rate, we used the company's statutory tax rate of 30%.

WACC: Our weighted average cost of capital (WACC) was calculated to be 9.5%. This used a risk-free rate of 2.49% based on the YTM of the 5-year US treasury bills, a beta of 1.33 as listed on Bloomberg, an expected market return of 10.4%, an effective tax rate of 30%, and a pre-tax cost of debt of 3.0%.

Terminal Multiple: We used an EV/EBITDA exit multiple of 7.0x based on the company's strategies of becoming a smaller yet more profitable company in 2019. This multiple is in range with the median multiple of its comparable companies, but based on the company's historical multiples, we believe this is a fair assumption. Fossil has historically had an EV/EBITDA multiple in line with its peers.

Comparable Company Analysis Set

The comparable company set was chosen based on Fossil's product categories, including watches, jewelry, leathers, and accessories. We also based these comparable companies on their relative size to Fossil and where they operate globally. Because Fossil is based in the US, we chose companies that do so as well. As for our terminal multiple, we chose 7.0x based on Fossil's comparable companies median multiple.

Guess?, Inc (NYSE:GES): Guess is an American clothing and fashion accessories brand and retailer. They sell clothing for both men and women, as well as watches, jewelry, perfume, and shoes.

Tapestry, Inc (NYSE:TPR): Tapestry is an American-based multinational luxury fashion holding company. It is the parent company to three major fashion brands: Coach New York, Kate Spade New York, and Stuart Weitzman. These companies sell a variety of fashion accessories, including watches, belts, sunglasses, handbags, shoes and jewelry.

Movado Group, Inc (NYSE: MOV): Movado is a watchmaker based in the US, originated in Switzerland. The company sells both traditional watches and smartwatches, known for their minimalistic style.

G-III Apparel Group (NASDAQ:GIII): G-III Apparel is an American clothing company that designs, manufactures, and markets clothing through a large collection of licensed brand names including Guess?, DKNY, Donna Karan, Calvin Klein, Tommy Hilfiger, Andrew Mark, Levi's, Dockers, and Wilsons.

Abercrombie & Fitch Co (NYSE:ANF): Abercrombie & Fitch is a casual clothing company based in the US with two sub-brands, Abercrombie Kids, and Hollister Co.

Ralph Lauren Corp (NYSE:RL): Ralph Lauren is an American company that produces apparel, home goods, accessories, and fragrances in the mid-range to luxury fashion categories. They have many smaller brand lines including Polo Ralph Lauren, Chaps, and Club Monaco.

Chico's FAS, Inc (NYSE:CHS): Chico's is an American retail clothing and fashion accessories company for women. They operate two other brands, White House Black Market and Soma.

Recommendation

Given these efforts, and the vulnerable position of the company at the moment due to changing consumer preferences and competition pressure, we believe that the market has valued the company fairly. Although it is uncertain if the company's restructuring initiatives will pay off in the future, they have already shown improvements in the company's profitability thus far and we expect that they will continue to stabilize sales and the bottom line in the long term. Based on our discounted cash flow analysis and comparable company analysis, we initiate a **Hold** rating for Fossil at a target price of \$18.00. In 2018, Fossil signed many agreements with various brands, including Puma, BMW, and Citizen, which provide the company with unique expansion opportunities. If the outcomes and quantifiable benefits of these agreements were clearer, this could reflect a higher valuation of the company.

Risks

Licensed Brand Risks

Sales of Fossil's licensed products accounted for 47.0% of net sales in 2017, which poses a significant risk if the company were not able to maintain these agreements. These licensing deals often involve obligations and expectations provided by the licensed brands that must be fulfilled, otherwise the agreement can be terminated. Failure to meet these requirements, such as inadequate sales of the brand's products, may result in early termination of the contracts. It is Fossil's responsibility to meet a specific net sales threshold outlined in the agreement. In addition, many of Fossil's contracts have expiration dates within the next five years and some brands may choose not to renew their agreements with the company. This situation occurred in 2017 with the licensing agreements of Adidas and Burberry. We believe Fossil is able to mitigate this risk by signing new agreements with other profitable brands. For example, its new deals with BMW and Puma both have the potential to take the place of exiting brands.

Licensed Brand	Expiration Date
Armani Exchange	12/31/2023
BMW	12/31/2023
Chaps	3/31/2020
Diesel	12/31/2025
DKNY	12/31/2019
Emporio Armani	12/31/2023
Kate Spade New York	12/31/2025
Marc Jacobs	6/30/2019
Michael Kors	12/31/2024
Puma	12/31/2028
Tory Burch	2/28/2019

Source: FY2018 Company Filings

Innovation Risks

Because the watch market has seen constant evolution and transformation in recent years, Fossil must compete with the level of innovation of its competitors in the industry. The company's success in the wearable technology industry will depend on their ability to adapt to consumer preferences and continued partnerships with technology companies.

Supply Chain Risks

Many of Fossil's products are manufactured using key components from limited supplies, such as watch cases, crystals, dials, hands, various modules, bracelets, and straps. Additionally, the prices of the raw materials used to produce these pieces can greatly influence the price of products, which poses a risk for consumer demand. Commodities such as gold, silver, or metals, face significant price volatility that can reflect uncertainty in the value of luxury products.

Macroeconomic Risks

Fossil conducts its manufacturing and distribution operations internationally, particularly in the US, China, Germany, Hong Kong, Vietnam, and Switzerland. In 2017, 58.5% of net sales were generated outside of the US, which means the company is vulnerable to foreign economic and exchange risks. Operations in these offshore locations are subject to macroeconomic conditions and events affecting those countries. With the bulk of its manufacturing and assembly located in China, Fossil faces uncertainty in the midst of the US-China trade war and the threat of possible tariffs. Additionally, the economic uncertainty in Europe poses a threat to the European revenue segment, due to the possible decline purchasing power.

Appendix 1: Model Summary

	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23
(Figures in mm CAD)	FY2013	FY2014	FY2015	FY2016	FY2017	Q1-2018	Q2-2018	Q3-2018	Q4-2018	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
Income Statement															
Revenue	3,260.0	3,509.7	3,228.8	3,042.4	2,788.2	569.2	576.6	608.8	786.9	2,541.5	2,294.1	2,224.6	2,148.3	2,095.0	2,065.5
EBITDA	643.5	662.5	412.4	249.5	112.0	9.1	36.8	44.8	92.4	183.1	91.8	89.0	85.9	83.8	82.6
Net Income	388.0	386.6	229.9	85.6	(473.6)	(47.5)	(7.2)	5.9	47.9	(0.9)	(55.7)	(29.5)	(23.5)	(18.6)	(14.8)
Earnings Per Share	\$ 6.56	\$ 7.10	\$ 4.51	\$ 1.63	\$ (9.87)	\$ (0.99)	\$ (0.16)	\$ 0.10	\$ 0.94	\$ (0.07)	\$ (1.13)	\$ (0.60)	\$ (0.48)	\$ (0.38)	\$ (0.30)
Cash Flow Statement															
Capital Expenditures	(95.2)	(94.8)	(79.8)	(65.7)	(25.5)	(3.8)	(2.4)	(3.9)	(7.8)	(18.0)	(16.5)	(11.1)	(7.2)	(5.3)	(3.4)
Acquisitions	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Divestitures	-	-	-	3.5	1.8	-	-	-	-	-	-	-	-	-	-
Balance Sheet															
Current Assets	1,479.5	1,489.9	1,442.7	1,347.3	1,291.0	1,156.4	1,069.3	1,148.5	1,258.6	1,258.6	1,114.5	1,105.7	1,096.5	1,090.7	1,084.8
Non-Current Assets	751.0	717.7	913.0	839.6	367.4	359.2	336.9	321.0	316.6	316.6	271.9	236.8	209.6	189.5	174.2
Assets	2,230.4	2,207.6	2,355.7	2,186.9	1,658.4	1,515.7	1,406.2	1,469.5	1,575.2	1,575.2	1,386.4	1,342.5	1,306.1	1,280.3	1,259.0
Current Liabilities	491.9	446.8	489.5	414.6	509.1	523.9	507.5	571.2	605.8	605.8	472.6	458.3	445.3	438.1	431.7
Non-Current Liabilities	663.1	776.9	933.6	756.9	568.3	465.2	381.8	368.8	380.8	380.8	380.8	380.8	380.8	380.8	380.8
Liabilities	1,155.0	1,223.8	1,423.1	1,171.5	1,077.4	989.1	889.4	940.0	986.6	986.6	853.4	839.1	826.1	818.9	812.4
Shareholders' Equity	1,068.7	977.9	921.4	1,006.2	576.1	521.4	515.0	526.8	585.5	585.5	529.9	500.4	476.9	458.3	443.5
Cash	320.5	276.3	289.3	297.3	231.2	229.9	241.8	236.1	403.4	403.4	260.4	267.0	310.2	323.9	351.6
Debt	(320.5)	(276.3)	(289.3)	(297.3)	(231.2)	(229.9)	(241.8)	(236.1)	(403.4)	(403.4)	(260.4)	(267.0)	(310.2)	(323.9)	(351.6)
Net Debt	6.7	5.9	11.2	9.2	4.8	5.1	1.9	2.8	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Minority Interests	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Debt/EBITDA	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Operating Metrics															
Return on Equity (ROE)	36.3%	39.5%	25.0%	8.5%	-82.2%	-	-	-	-	-0.2%	-10.5%	-5.9%	-4.9%	-4.1%	-3.3%
Return on Assets (ROA)	17.4%	17.5%	9.8%	3.9%	-28.6%	-	-	-	-	-0.1%	-4.0%	-2.2%	-1.8%	-1.5%	-1.2%
Return on Invested Capital (ROIC)	27.4%	26.0%	14.6%	5.8%	-51.6%	-	-	-	-	-0.2%	-8.6%	-4.8%	-4.3%	-3.6%	-3.2%
Valuation Metrics															
Stock Price (High)	\$ 134.99	\$ 125.00	\$ 112.06	\$ 51.93	\$ 27.33	\$ 18.00	\$ 32.17	\$ 30.20	\$ 24.28	\$ 32.17	\$ 16.50	\$ 16.50	\$ 16.50	\$ 16.50	\$ 16.50
Stock Price (Low)	\$ 88.65	\$ 91.84	\$ 30.65	\$ 23.10	\$ 5.50	\$ 7.16	\$ 12.04	\$ 20.50	\$ 13.59	\$ 7.16	\$ 16.50	\$ 16.50	\$ 16.50	\$ 16.50	\$ 16.50
Stock Price (Average)	\$ 111.82	\$ 108.42	\$ 71.35	\$ 37.52	\$ 16.42	\$ 12.58	\$ 22.10	\$ 25.35	\$ 18.94	\$ 19.66	\$ 16.50	\$ 16.50	\$ 16.50	\$ 16.50	\$ 16.50
Diluted Shares Outstanding (Average)	57.7	53.1	48.9	48.3	48.5	48.7	49.2	50.7	50.6	49.2	49.2	49.2	49.2	49.2	49.2
Market Capitalization (Average)	6,449.3	5,754.9	3,491.0	1,812.8	795.6	612.8	1,088.2	1,284.2	958.1	967.4	811.7	811.7	811.7	811.7	811.7
Enterprise Value (Average)	6,135.5	5,484.6	3,212.9	1,524.7	569.2	388.0	848.3	1,050.9	557.8	567.2	554.4	547.8	504.6	490.9	463.3
P/E	17.1 x	15.3 x	15.8 x	23.0 x	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
EV/EBITDA	9.5 x	8.3 x	7.8 x	6.1 x	5.1 x	3.1 x	6.0 x	6.2 x	5.9 x	5.9 x	6.0 x	6.2 x	5.9 x	5.9 x	5.6 x
FCF Yield to Market Capitalization	4.7%	4.6%	7.2%	9.5%	27.9%	28.0%	-8.1%	8.1%	12.6%	9.0%	10.7%	12.1%	20.3%	14.9%	18.8%
FCF Yield to Enterprise Value	4.9%	4.9%	7.8%	11.3%	39.0%	47.8%	-11.9%	12.1%	20.3%	14.9%	18.8%	12.1%	20.3%	14.9%	18.8%
Free Cash Flow															
EBIT	561.6	566.5	324.8	154.9	31.0	(7.0)	21.8	28.7	72.0	115.6	30.5	42.8	51.5	58.4	63.9
Tax Expense	(173.4)	(171.5)	(81.8)	(28.7)	(19.8)	(6.6)	3.4	(3.9)	(21.6)	(34.7)	(9.1)	(12.8)	(15.4)	(17.5)	(19.2)
D&A	81.9	95.9	87.7	94.6	81.0	16.0	15.1	16.1	20.4	67.6	61.3	46.2	34.5	25.4	18.7
Capital Expenditures	(95.2)	(94.8)	(79.8)	(65.7)	(25.5)	(3.8)	(2.4)	(3.9)	(7.8)	(18.0)	(16.5)	(11.1)	(7.2)	(5.3)	(3.4)
Changes in NWC	(71.9)	(129.9)	0.0	17.3	155.1	17.5	78.2	(42.1)	86.7	140.3	(132.1)	1.1	39.4	12.3	27.1
Unlevered Free Cash Flow	303.0	266.4	250.9	172.5	221.8	16.0	116.0	(5.1)	149.8	270.8	(66.0)	66.1	102.7	73.2	87.1
Valuation Summary															
Current Price															
Target Price															
Total Return															
Recommendation															
DCF Valuation															
Perpetuity Growth Implied Price															
Exit Multiple Implied Price															
Comps Valuation															
Comps - EV/EBITDA Implied Price															
Comps - P/E Implied Price															

Appendix 2: DCF Analysis

	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23
(Figures in mm CAD)	FY2013	FY2014	FY2015	FY2016	FY2017	Q1-2018	Q2-2018	Q3-2018	Q4-2018	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
WACC Calculations															
Cost of Equity															
Risk-free rate	2.5%														
Expected market return	10.4%														
Market Risk Premium	7.9%														
Beta	1.33														
Cost of Equity	12.9%														
Cost of Debt															
Pre-tax cost of debt	3.0%														
Effective tax rate	30.0%														
Cost of Debt	2.1%														
WACC															
Market value of equity	835.9														
Market value of debt	397.1														
Total Capitalization	1,233.0														
Cost of equity	12.9%														
Cost of debt	2.1%														
WACC	9.4%														
Free Cash Flow															
EBIT	561.6	566.5	324.8	154.9	31.0	(7.0)	21.8	28.7	72.0	115.6	30.5	42.8	51.5	58.4	63.9
Less: Tax expense	(173.4)	(171.5)	(81.8)	(28.7)	(19.8)	(6.6)	3.4	(3.9)	(21.6)	(34.7)	(9.1)	(12.8)	(15.4)	(17.5)	(19.2)
Add: Depreciation and amortization	81.9	95.9	87.7	94.6	81.0	16.0	15.1	16.1	20.4	67.6	61.3	46.2	34.5	25.4	18.7
Less: Capital expenditures	(95.2)	(94.8)	(79.8)	(65.7)	(25.5)	(3.8)	(2.4)	(3.9)	(7.8)	(18.0)	(16.5)	(11.1)	(7.2)	(5.3)	(3.4)
Less: Change in net working capital	(71.9)	(129.9)	0.0	17.3	155.1	17.5	78.2	(42.1)	86.7	140.3	(132.1)	1.1	39.4	12.3	27.1
Unlevered Free Cash Flow	303.0	266.4	250.9	172.5	221.8	16.0	116.0	(5.1)	149.8	270.8	(66.0)	66.1	102.7	73.2	87.1
Discount factor						-	-	-	0.25	0.25	1.25	2.25	3.25	4.25	5.25
Present Value of Unlevered Free Cash Flow						-	-	-	146.5	146.5	(68.1)	54.0	76.6	49.9	54.2
Discounted Cash Flow Valuations															
Perpetuity Growth Method															
Perpetuity Growth Rate	2.0%														
PV sum of unlevered FCF	313.0														
Terminal value	743.1														
Enterprise Value	1,056.1														
Add: Cash	237.8														
Less: Debt	397.1														
Less: Other EV adjustments	2.8														
Equity Value	894.0														
Shares outstanding	50.7														
Implied Share Price	\$ 17.65														
Current Price	\$ 16.50														
Implied Price	\$ 17.65														
Total Return	7.0%														
Exit Multiple Method															
Terminal EV/EBITDA Multiple	7.0 x														
PV sum of unlevered FCF	313.0														
Terminal value	360.0														
Enterprise Value	673.1														
Add: Cash	237.8														
Less: Debt	397.1														
Less: Other EV adjustments	2.8														
Equity Value	511.0														
Shares outstanding	50.7														
Implied Share Price	\$ 10.09														
Current Price	\$ 16.50														
Implied Price	\$ 10.09														
Total Return	-38.9%														
WACC															
										9.00%	8.50%	8.00%	7.50%	7.00%	
Perpetuity Growth Rate	1.00%	\$ 16.87	\$ 18.23	\$ 19.80	\$ 21.60	\$ 23.71									
	1.50%	\$ 17.86	\$ 19.39	\$ 21.16	\$ 23.22	\$ 25.66									
	2.00%	\$ 19.00	\$ 20.73	\$ 22.75	\$ 25.14	\$ 28.01									
	2.50%	\$ 20.31	\$ 22.29	\$ 24.63	\$ 27.44	\$ 30.88									
	3.00%	\$ 21.84	\$ 24.13	\$ 26.88	\$ 30.25	\$ 34.46									
WACC															
										9.00%	8.50%	8.00%	7.50%	7.00%	
Terminal EV/EBITDA Multiple	8.0 x	\$ 11.35	\$ 11.64	\$ 11.94	\$ 12.24	\$ 12.56									
	9.0 x	\$ 12.39	\$ 12.70	\$ 13.03	\$ 13.36	\$ 13.70									
	10.0 x	\$ 13.43	\$ 13.77	\$ 14.12	\$ 14.47	\$ 14.84									
	11.0 x	\$ 14.47	\$ 14.83	\$ 15.20	\$ 15.59	\$ 15.99									
	12.0 x	\$ 15.50	\$ 15.89	\$ 16.29	\$ 16.71	\$ 17.13									

Appendix 3: Comparable Company Analysis

(Figures in mm CAD)				EV/EBITDA Multiple			P/E Multiple		
Company	Ticker	Equity Value	Enterprise Value	2017A EV/EBITDA	2018E EV/EBITDA	2019E EV/EBITDA	2017A P/E	2018E P/E	2019E P/E
Guess?, Inc	(NYSE: GES)	1,715.6	1,635.0	8.9 x	8.7 x	7.4 x	(192.5 x)	20.6 x	15.6 x
Tapestry, Inc	(NYSE: TPR)	9,972.0	10,510.0	9.0 x	7.8 x	7.1 x	18.5 x	12.3 x	11.1 x
Movado Group, Inc	(NYSE: MOV)	745.9	652.5	7.8 x			73.4 x	12.7 x	11.1 x
G-III Apparel Group	(NASDAQ: GIII)	1,409.9	2,038.1	8.0 x	7.6 x	6.9 x	12.7 x	10.4 x	9.2 x
Abercrombie & Fitch C	(NYSE: ANF)	1,358.1	1,143.6	3.4 x	3.8 x	3.9 x	27.5 x	21.7 x	18.3 x
Ralph Lauren Corp	(NYSE: RL)	8,477.4	7,543.4	7.8 x	7.7 x	7.3 x	36.6 x	15.5 x	14.3 x
Chico's FAS, Inc.	(NYSE: CHS)	737.9	570.3	3.0 x	3.9 x	4.0 x	9.3 x	17.8 x	22.6 x
Fossil Group, Inc.	(NASDAQ: FOSL)	835.9	998.0	8.9 x	5.4 x	10.9 x	(1.7 x)	(233.4 x)	(14.6 x)
Median					7.6 x	7.0 x		15.5 x	14.3 x
Mean					6.6 x	6.1 x		15.9 x	14.6 x
High					8.7 x	7.4 x		21.7 x	22.6 x
Low					3.8 x	3.9 x		10.4 x	9.2 x
				EV/EBITDA Implied Price			P/E Implied Price		
Median				\$	24.45	\$ 9.48	-\$	1.10	-\$ 16.14
Mean				\$	20.57	\$ 7.83	-\$	1.12	-\$ 16.51
High				\$	28.17	\$ 10.22	-\$	1.54	-\$ 25.54
Low				\$	10.36	\$ 3.78	-\$	0.74	-\$ 10.42

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Ali Cervienka
Analyst

WestPeak Research Association
contact@westpeakresearch.com