

RALPH LAUREN CORP
Form 10-Q
August 07, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 28, 2014

or
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 001-13057

Ralph Lauren Corporation
(Exact name of registrant as specified in its charter)
Delaware

(State or other jurisdiction of
incorporation or organization)
650 Madison Avenue,
New York, New York

(Address of principal executive offices)
(212) 318-7000

13-2622036
(I.R.S. Employer
Identification No.)
10022
(Zip Code)

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At August 1, 2014, 61,064,929 shares of the registrant's Class A common stock, \$.01 par value, and 26,881,276 shares of the registrant's Class B common stock, \$.01 par value, were outstanding.

RALPH LAUREN CORPORATION
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RALPH LAUREN CORPORATION
CONSOLIDATED BALANCE SHEETS

	June 28, 2014 (millions) (unaudited)	March 29, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$711	\$797
Short-term investments	658	488
Accounts receivable, net of allowances of \$261 million and \$270 million	357	588
Inventories	1,180	1,020
Income tax receivable	61	62
Deferred tax assets	152	150
Prepaid expenses and other current assets	202	224
Total current assets	3,321	3,329
Property and equipment, net	1,363	1,322
Deferred tax assets	39	39
Goodwill	963	964
Intangible assets, net	293	299
Other non-current assets	151	137
Total assets	\$6,130	\$6,090
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	\$260	\$203
Income tax payable	96	77
Accrued expenses and other current liabilities	705	690
Total current liabilities	1,061	970
Long-term debt	300	300
Non-current liability for unrecognized tax benefits	136	132
Other non-current liabilities	661	654
Commitments and contingencies (Note 14)		
Total liabilities	2,158	2,056
Equity:		
Class A common stock, par value \$.01 per share; 98.6 million and 98.0 million shares issued; 61.1 million and 61.8 million shares outstanding	1	1
Class B common stock, par value \$.01 per share; 26.9 million shares issued and outstanding	—	—
Additional paid-in-capital	2,017	1,979
Retained earnings	5,369	5,257
Treasury stock, Class A, at cost; 37.5 million and 36.2 million shares	(3,528	) (3,317
Accumulated other comprehensive income	113	114
Total equity	3,972	4,034
Total liabilities and equity	\$6,130	\$6,090
See accompanying notes.		

RALPH LAUREN CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended	
	June 28, 2014	June 29, 2013
	(millions, except per share data) (unaudited)	
Net sales	\$1,668	\$1,614
Licensing revenue	40	39
Net revenues	1,708	1,653
Cost of goods sold ^(a)	(665	) (649
Gross profit	1,043	1,004
Selling, general, and administrative expenses ^(a)	(789	) (735
Amortization of intangible assets	(6	) (9
Gain on acquisition of Chaps	—	16
Restructuring and other charges	(4) —
Total other operating expenses, net	(799	) (728
Operating income	244	276
Foreign currency losses	(3	) (6
Interest expense	(4	) (5
Interest and other income, net	1	2
Equity in losses of equity-method investees	(3	) (2
Income before provision for income taxes	235	265
Provision for income taxes	(73	) (84
Net income	\$162	\$181
Net income per common share:		
Basic	\$1.82	\$1.99
Diluted	\$1.80	\$1.94
Weighted average common shares outstanding:		
Basic	88.9	90.8
Diluted	90.2	93.1
Dividends declared per share	\$0.45	\$0.40
^(a) Includes total depreciation expense of:	\$(63	) \$(51

See accompanying notes.

RALPH LAUREN CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended	
	June 28, 2014	June 29, 2013
	(millions)	
	(unaudited)	
Net income	\$162	\$181
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(3	) (2
Net realized and unrealized gains (losses) on derivatives	2	(5
Net realized and unrealized losses on available-for-sale investments	—	(5
Other comprehensive loss, net of tax	(1	) (12
Total comprehensive income	\$161	\$169

See accompanying notes.

RALPH LAUREN CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	June 28, 2014	June 29, 2013
	(millions)	
	(unaudited)	
Cash flows from operating activities:		
Net income	\$162	\$181
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	69	60
Deferred income tax benefit	(3	) (8
Equity in losses of equity-method investees	3	2
Non-cash stock-based compensation expense	23	22
Gain on acquisition of Chaps	—	(16
Excess tax benefits from stock-based compensation arrangements	(4	) (17
Other non-cash charges, net	6	1
Changes in operating assets and liabilities:		
Accounts receivable	230	131
Inventories	(158	) (129
Prepaid expenses and other current assets	5	(12
Accounts payable and accrued liabilities	79	4
Income tax receivables and payables	27	42
Deferred income	(4	) (6
Other balance sheet changes, net	(20	) 40
Net cash provided by operating activities	415	295
Cash flows from investing activities:		
Capital expenditures	(85	) (66
Purchases of investments	(411	) (305
Proceeds from sales and maturities of investments	236	298
Acquisitions and ventures	(4	) (32
Change in restricted cash deposits	—	(2
Net cash used in investing activities	(264	) (107
Cash flows from financing activities:		
Payments of capital lease obligations	(5	) (2
Payments of dividends	(40	) (36
Repurchases of common stock, including shares surrendered for tax withholdings	(211	) (151
Prepayments of common stock repurchases	—	(50
Proceeds from exercises of stock options	14	5
Excess tax benefits from stock-based compensation arrangements	4	17
Net cash used in financing activities	(238	) (217
Effect of exchange rate changes on cash and cash equivalents	1	(5
Net decrease in cash and cash equivalents	(86	) (34
Cash and cash equivalents at beginning of period	797	974
Cash and cash equivalents at end of period	\$711	\$940
See accompanying notes.		

RALPH LAUREN CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In millions, except per share data and where otherwise indicated)
(Unaudited)

1. Description of Business

Ralph Lauren Corporation ("RLC") is a global leader in the design, marketing, and distribution of premium lifestyle products, including men's, women's, and children's apparel, accessories, fragrances, and home furnishings. RLC's long-standing reputation and distinctive brands have been consistently developed across an expanding number of products, brands, sales channels, and international markets. RLC's brand names include Ralph Lauren, Ralph Lauren Collection, Purple Label, Black Label, Polo, Polo Ralph Lauren, Blue Label, RRL, RLX Ralph Lauren, Lauren Ralph Lauren, Ralph Lauren Childrenswear, Denim & Supply Ralph Lauren, Chaps, Club Monaco, and American Living, among others. RLC and its subsidiaries are collectively referred to herein as the "Company," "we," "us," "our," and "ourselves," unless the context indicates otherwise.

The Company classifies its businesses into three segments: Wholesale, Retail, and Licensing. The Company's wholesale sales are made principally to major department stores and specialty stores around the world. The Company also sells directly to consumers through its integrated retail channel, which includes retail stores around the world; concession-based shop-within-shops located in Asia, Australia, New Zealand, and Europe; and retail e-commerce operations in North America, Europe, and Asia. The Company also licenses to unrelated third parties for specified periods the right to operate retail stores and to use its various trademarks in connection with the manufacture and sale of designated products, such as apparel, eyewear, and fragrances.

2. Basis of Presentation

Interim Financial Statements

These interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") and are unaudited. In the opinion of management, such consolidated financial statements contain all normal and recurring adjustments necessary to present fairly the consolidated financial position, income, comprehensive income, and cash flows of the Company for the interim periods presented. In addition, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP") have been condensed or omitted from this report as is permitted by the SEC's rules and regulations. However, the Company believes that the disclosures provided herein are adequate to prevent the information presented from being misleading. This report should be read in conjunction with the Company's Annual Report on Form 10-K filed with the SEC for the fiscal year ended March 29, 2014 (the "Fiscal 2014 10-K").

Basis of Consolidation

These unaudited interim consolidated financial statements present the consolidated financial position, income, comprehensive income, and cash flows of the Company, including all entities in which the Company has a controlling financial interest and is determined to be the primary beneficiary. All significant intercompany balances and transactions have been eliminated in consolidation.

Fiscal Periods

The Company utilizes a 52-53 week fiscal year ending on the Saturday closest to March 31. As such, fiscal year 2015 will end on March 28, 2015 and will be a 52-week period ("Fiscal 2015"). Fiscal year 2014 ended on March 29, 2014 and was also a 52-week period ("Fiscal 2014"). The first quarter of Fiscal 2015 ended on June 28, 2014 and was a 13-week period. The first quarter of Fiscal 2014 ended on June 29, 2013 and was also a 13-week period.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and footnotes thereto. Actual results could differ materially from those estimates.

RALPH LAUREN CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Significant estimates inherent in the preparation of the consolidated financial statements include reserves for bad debt, customer returns, discounts, end-of-season markdowns, and operational chargebacks; the realizability of inventory; reserves for litigation and other contingencies; useful lives and impairments of long-lived tangible and intangible assets; accounting for income taxes and related uncertain tax positions; the valuation of stock-based compensation awards and related estimated forfeiture rates; reserves for restructuring; and accounting for business combinations, among others.

Reclassifications

Certain reclassifications have been made to the prior period's financial information in order to conform to the current period's presentation, including a change in the manner in which the Company allocates certain costs to its reportable segments, as described in Note 22 to the Company's Fiscal 2014 Form 10-K.

Seasonality of Business

The Company's business is typically affected by seasonal trends, with higher levels of wholesale sales in its second and fourth quarters and higher retail sales in its second and third quarters. These trends result primarily from the timing of seasonal wholesale shipments and key vacation travel, back-to-school, and holiday shopping periods in the Retail segment. In addition, fluctuations in sales, operating income, and cash flows in any fiscal quarter may be affected by other events affecting retail sales, such as changes in weather patterns. Accordingly, the Company's operating results and cash flows for the three-month period ended June 28, 2014 are not necessarily indicative of the operating results and cash flows that may be expected for the full Fiscal 2015.

3. Summary of Significant Accounting Policies

Revenue Recognition

Revenue is recognized across all segments of the business when there is persuasive evidence of an arrangement, delivery has occurred, the price has been fixed or is determinable, and collectability is reasonably assured.

Revenue within the Company's Wholesale segment is recognized at the time title passes and risk of loss is transferred to customers. Wholesale revenue is recorded net of estimates of returns, discounts, end-of-season markdown reserves, operational chargebacks, and certain cooperative advertising allowances. Returns and allowances require pre-approval from management and discounts are based on trade terms. Estimates for end-of-season markdown reserves are based on historical trends, actual and forecasted seasonal results, an evaluation of current economic and market conditions, retailer performance, and, in certain cases, contractual terms. Estimates for operational chargebacks are based on actual notifications of order fulfillment discrepancies and historical trends. The Company reviews and refines these estimates on at least a quarterly basis. The Company's historical estimates of these costs have not differed materially from actual results.

Retail store and concession-based shop-within-shop revenue is recognized net of estimated returns at the time of sale to consumers. E-commerce revenue from sales of products ordered through the Company's e-commerce sites is recognized upon delivery of the shipment to its customers. Such revenue is also reduced by an estimate of returns.

Gift cards issued by the Company are recorded as a liability until they are redeemed, at which point revenue is recognized. The Company recognizes income for unredeemed gift cards when the likelihood of redemption by a customer is remote and the Company determines that it does not have a legal obligation to remit the value of the unredeemed gift card to the relevant jurisdiction as unclaimed or abandoned property.

Revenue from licensing arrangements is recognized when earned in accordance with the terms of the underlying agreements, generally based upon the higher of (i) contractually guaranteed minimum royalty levels or (ii) actual sales and royalty data, or estimates thereof, received from the Company's licensees.

The Company accounts for sales taxes and other related taxes on a net basis, excluding such taxes from revenue.

RALPH LAUREN CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Shipping and Handling Costs

The costs associated with shipping goods to customers are reflected as a component of selling, general, and administrative ("SG&A") expenses in the unaudited interim consolidated statements of income. Shipping costs were approximately \$9 million and \$8 million during the three-month periods ended June 28, 2014 and June 29, 2013, respectively. The costs of preparing merchandise for sale, such as picking, packing, warehousing, and order charges ("handling costs") are also included in SG&A expenses. Handling costs were approximately \$42 million and \$39 million during the three-month periods ended June 28, 2014 and June 29, 2013, respectively. Shipping and handling costs billed to customers are included in revenue.

Net Income per Common Share

Basic net income per common share is computed by dividing net income applicable to common shares by the weighted-average number of common shares outstanding during the period. Weighted-average common shares include shares of the Company's Class A and Class B common stock. Diluted net income per common share adjusts basic net income per common share for the effects of outstanding stock options, restricted stock, restricted stock units ("RSUs"), and any other potentially dilutive instruments, only in the periods in which such effects are dilutive under the treasury stock method.

The weighted-average number of common shares outstanding used to calculate basic net income per common share is reconciled to shares used to calculate diluted net income per common share as follows:

	Three Months Ended	
	June 28, 2014	June 29, 2013
	(millions)	
Basic shares	88.9	90.8
Dilutive effect of stock options, restricted stock, and RSUs	1.3	2.3
Diluted shares	90.2	93.1

All earnings per share amounts have been calculated based on unrounded numbers. Options to purchase shares of the Company's common stock at an exercise price greater than the average market price of the common stock during the reporting period are anti-dilutive and therefore not included in the computation of diluted net income per common share. In addition, the Company has outstanding RSUs that are issuable only upon the achievement of certain service and/or performance goals. Performance-based RSUs are included in the computation of diluted shares only to the extent that the underlying performance conditions (and any applicable market condition modifiers) (i) are satisfied as of the end of the reporting period or (ii) would be considered satisfied if the end of the reporting period were the end of the related contingency period and the result would be dilutive under the treasury stock method. As of June 28, 2014 and June 29, 2013, there were approximately 1.2 million and 0.5 million, respectively, additional shares issuable upon exercise of anti-dilutive options and contingent vesting of performance-based RSUs, which were excluded from the diluted share calculations.

Accounts Receivable

In the normal course of business, the Company extends credit to wholesale customers that satisfy defined credit criteria. Accounts receivable, net is recorded at carrying value, which approximates fair value, and is presented in the Company's consolidated balance sheets net of certain reserves and allowances. These reserves and allowances consist of (i) reserves for returns, discounts, end-of-season markdowns, operational chargebacks, and certain cooperative advertising allowances (see Revenue Recognition section above for further discussion of related accounting policies) and (ii) allowances for doubtful accounts.

RALPH LAUREN CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A rollforward of the activity in the Company's reserves for returns, discounts, end-of-season markdowns, operational chargebacks, and certain cooperative advertising allowances is presented below:

	Three Months Ended	
	June 28, 2014	June 29, 2013
	(millions)	
Beginning reserve balance	\$254	\$230
Amount charged against revenue to increase reserve	157	153
Amount credited against customer accounts to decrease reserve	(165	) (140
Foreign currency translation	(1	) 2
Ending reserve balance	\$245	\$245

An allowance for doubtful accounts is determined through analysis of periodic aging of accounts receivable, assessments of collectability based on an evaluation of historical and anticipated trends, the financial condition of the Company's customers, and an evaluation of the impact of economic conditions, among other factors. The Company's allowance for doubtful accounts was \$16 million as of both June 28, 2014 and March 29, 2014. The change in the allowance for doubtful accounts was not material during either of the three-month periods ended June 28, 2014 and June 29, 2013.

Concentration of Credit Risk

The Company sells its wholesale merchandise primarily to major department and specialty stores around the world, and extends credit based on an evaluation of each customer's financial capacity and condition, usually without requiring collateral. In the Company's wholesale business, concentration of credit risk is relatively limited due to the large number of customers and their dispersion across many geographic areas. However, the Company has three key wholesale customers that generate significant sales volume. During Fiscal 2014, the Company's sales to its largest wholesale customer, Macy's, Inc. ("Macy's"), accounted for approximately 12% of its total net revenues, and the Company's sales to its three largest wholesale customers (including Macy's) represented approximately 25% of total net revenues during Fiscal 2014. As of June 28, 2014, these three key wholesale customers represented approximately 30% of gross accounts receivable.

Derivative Financial Instruments

The Company records all derivative financial instruments on its consolidated balance sheets at fair value. For derivative instruments that qualify for cash flow hedge accounting, the effective portion of changes in the fair value of these instruments is recognized in equity as a component of accumulated other comprehensive income ("AOCI") until the hedged item is recognized in earnings.

Each derivative instrument entered into by the Company that qualifies for hedge accounting is expected to be highly effective at reducing the risk associated with the exposure being hedged. For each derivative instrument that is designated as a hedge, the Company formally documents the related risk management objective and strategy, including identification of the hedging instrument, the hedged item, and the risk exposure, as well as how hedge effectiveness will be assessed prospectively and retrospectively over the term of the instrument. To assess the effectiveness of derivative instruments that are designated as hedges, the Company uses regression analysis, a statistical method, to compare the change in the fair value of the derivative instrument to the change in cash flows of the related hedged item. The extent to which a hedging instrument has been and is expected to remain highly effective in achieving offsetting changes in cash flows is assessed and documented by the Company on at least a quarterly basis.

To the extent that a derivative instrument designated as a cash flow hedge is not considered to be effective, any change in its fair value relating to such ineffectiveness is immediately recognized in earnings within foreign currency gains (losses). If it is determined that a derivative instrument has not been highly effective, and will continue not to be highly effective in hedging the designated exposure, hedge accounting is discontinued and further gains (losses) are recognized in earnings within foreign currency gains (losses). Upon discontinuance of hedge accounting, the

cumulative change in fair value of the derivative instrument previously

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RALPH LAUREN CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recorded in AOCI is recognized in earnings when the related hedged item affects earnings, consistent with the original hedging strategy, unless the forecasted transaction is no longer probable of occurring, in which case the accumulated amount is immediately recognized in earnings within foreign currency gains (losses).

As a result of the use of derivative instruments, the Company is exposed to the risk that the counterparties to such contracts will fail to meet their contractual obligations. To mitigate this counterparty credit risk, the Company has a policy of only entering into contracts with carefully selected financial institutions based upon an evaluation of their credit ratings and certain other factors, adhering to established limits for credit exposure. The Company's established policies and procedures for mitigating credit risk from derivative transactions include ongoing review and assessment of the creditworthiness of counterparties. The Company also enters into master netting arrangements with counterparties, when possible, to mitigate credit risk associated with its derivative instruments. In the event of default or termination (as such terms are defined within the respective master netting arrangement), these arrangements allow the Company to net-settle amounts payable and receivable related to multiple derivative transactions with the same counterparty. The master netting arrangements specify a number of events of default and termination, including, among others, the failure to make timely payments.

The fair values of the Company's derivative instruments are recorded on its consolidated balance sheets on a gross basis. For cash flow reporting purposes, the Company classifies proceeds received or amounts paid upon the settlement of a derivative instrument in the same manner as the related item being hedged, primarily within cash from operating activities.

Forward Foreign Currency Exchange Contracts

The Company primarily enters into forward foreign currency exchange contracts as hedges to reduce its risks related to exchange rate fluctuations on inventory purchases, intercompany royalty payments made by certain of its international operations, intercompany contributions made to fund certain marketing efforts of its international operations, and other foreign currency-denominated operational cash flows. To the extent forward foreign currency exchange contracts designated as cash flow hedges are highly effective in offsetting changes in the value of the hedged items, the related gains (losses) are initially deferred in equity as a component of AOCI and subsequently recognized in the consolidated statements of income as follows:

• **Forecasted Inventory Purchases** — Recognized as part of the cost of the inventory purchases being hedged within cost of goods sold when the related inventory is sold to a third party.

• **Intercompany Royalty Payments and Marketing Contributions** — Recognized within foreign currency gains (losses) generally in the period in which the related payments or contributions being hedged are received or paid.

Undesignated Hedges

All of the Company's undesignated hedges are entered into to hedge specific economic risks, particularly foreign currency exchange rate risk. Changes in the fair value of undesignated derivative instruments are immediately recognized in earnings within foreign currency gains (losses).

See Note 13 for further discussion of the Company's derivative financial instruments.

Refer to Note 3 in the Fiscal 2014 10-K for a summary of all of the Company's significant accounting policies.

4. Recently Issued Accounting Standards

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"). ASU 2014-09 provides a single, comprehensive accounting model for revenues arising from contracts with customers that supersedes most of the existing revenue recognition guidance, including industry-specific guidance. Under this model, revenue is recognized at an amount that an entity expects to be entitled to upon transferring control of goods or services to a customer, as opposed to when risks and rewards transfer to a customer under existing revenue recognition guidance.

RALPH LAUREN CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

ASU 2014-09 is effective for the Company beginning in its fiscal year 2018, and may be applied retrospectively to all prior periods presented or through a cumulative adjustment to the opening retained earnings balance in the year of adoption. The Company is currently in the process of evaluating the impact of ASU 2014-09 on its consolidated financial statements.

Proposed Amendments to Current Accounting Standards

The FASB is currently working on amendments to existing accounting standards governing a number of areas including, but not limited to, accounting for leases. In May 2013, the FASB issued an exposure draft, "Leases" (the "Exposure Draft"), which would replace the existing guidance in ASC topic 840, "Leases." Under the Exposure Draft, among other changes in practice, a lessee's rights and obligations under most leases, including existing and new arrangements, would be recognized as assets and liabilities on the consolidated balance sheet. The comment period for the Exposure Draft ended in September 2013. The FASB is currently redeliberating certain portions of the proposal to determine next steps. If and when effective, this proposed standard will likely have a significant impact on the Company's consolidated financial statements. However, as the standard-setting process is still ongoing, the Company is unable at this time to determine the impact this proposed change in accounting would have on its consolidated financial statements.

5. Acquisitions

Chaps Menswear License Acquisition

On April 10, 2013, in connection with the transition of the North American Chaps-branded men's sportswear business ("Chaps Menswear Business") from a licensed to a wholly-owned operation, the Company entered into an agreement with The Warnaco Group, Inc. ("Warnaco"), a subsidiary of PVH Corp. ("PVH"), to acquire certain net assets in exchange for an aggregate payment of approximately \$18 million (the "Chaps Menswear License Acquisition"). Warnaco was the Company's licensee for the Chaps Menswear Business. The Company funded the Chaps Menswear License Acquisition during the first quarter of Fiscal 2014 with available cash on-hand.

The Company accounted for the Chaps Menswear License Acquisition as a business combination during the first quarter of Fiscal 2014. The acquisition cost was allocated to the assets acquired and liabilities assumed based on an assessment of their respective fair values, as follows (in millions):

Assets acquired:

Inventory	\$30	
Accounts receivable	19	
Licensed trademark intangible asset	9	
Total assets acquired	58	
Liabilities assumed:		
Accounts payable	(22)
Other net liabilities	(2)
Total net liabilities assumed	(24)
Fair value of net assets acquired	34	
Consideration paid	18	
Gain on acquisition ^(a)	\$16	

^(a) Represents the difference between the acquisition date fair value of net assets acquired and the contractually-defined purchase price under the Company's license agreement with Warnaco, which granted the Company the right to early-terminate the license upon PVH's acquisition of Warnaco in February 2013.

RALPH LAUREN CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The licensed trademark intangible asset was valued using the excess earnings method, discounting the estimated after-tax cash flows associated with the Chaps-branded men's sportswear licensed trademark as of the acquisition date, factoring in market participant-based operating and cash flow assumptions. The reacquired licensed trademark intangible asset was amortized over a nine-month period through December 31, 2013, representing the remaining term of the prior license agreement that was terminated in connection with this acquisition.

The operating results of the Chaps Menswear Business have been consolidated into the Company's operating results beginning on April 10, 2013. Transaction costs of \$3 million were expensed as incurred and classified within SG&A expenses in the consolidated statement of income during the three months ended June 29, 2013.

Australia and New Zealand Licensed Operations Acquisition

On July 1, 2013, in connection with the transition of the Ralph Lauren-branded apparel and accessories business in Australia and New Zealand (the "Australia and New Zealand Business") from a licensed to a wholly-owned operation, the Company acquired certain net assets from Oroton Group/PRL Australia ("Oroton") in exchange for an aggregate payment of approximately \$15 million. The Company funded this acquisition with available cash on-hand and accounted for it as a business combination during the second quarter of Fiscal 2014, with the operating results of the Australia and New Zealand Business consolidated into the Company's operating results beginning on July 1, 2013. See Note 5 to the Company's Fiscal 2014 Form 10-K for the allocation of the purchase price and other information related to this acquisition.

6. Inventories

Inventories consist of the following:

	June 28, 2014 (millions)	March 29, 2014	June 29, 2013
Raw materials	\$3	\$3	\$5
Work-in-process	2	2	2
Finished goods	1,175	1,015	1,046
Total inventories	\$1,180	\$1,020	\$1,053

7. Property and Equipment

Property and equipment, net consists of the following:

	June 28, 2014 (millions)	March 29, 2014
Land and improvements	\$17	\$17
Buildings and improvements	185	183
Furniture and fixtures	676	661
Machinery and equipment	293	245
Capitalized software	372	366
Leasehold improvements	1,078	1,064
Construction in progress	326	312
	2,947	2,848
Less: accumulated depreciation	(1,584)	(1,526)
Property and equipment, net	\$1,363	\$1,322

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Other Current and Non-Current Liabilities

Accrued expenses and other current liabilities consist of the following:

	June 28, 2014 (millions)	March 29, 2014
Accrued operating expenses	\$182	\$183
Accrued inventory	155	84
Accrued payroll and benefits	127	190
Other taxes payable	87	76
Deferred income	42	41
Dividends payable	39	40
Accrued capital expenditures	38	45
Capital lease obligations	18	16
Other accrued expenses and current liabilities	17	15
Total accrued expenses and other current liabilities	\$705	\$690

Other non-current liabilities consist of the following:

	June 28, 2014 (millions)	March 29, 2014
Capital lease obligations	\$256	\$255
Deferred rent obligations	224	224
Deferred tax liabilities	78	81
Deferred compensation	43	29
Deferred income	35	39
Other non-current liabilities	25	26
Total other non-current liabilities	\$661	\$654

9. Restructuring and Other Charges

A description of significant restructuring and other activities and related costs is included below.

Fiscal 2015

During the three months ended June 28, 2014, the Company recorded \$4 million in restructuring charges, primarily related to severance and benefit costs associated with the Company's retail and wholesale operations. The related restructuring liability is expected to be paid by the end of fiscal year 2016.

Fiscal 2014

During Fiscal 2014, the Company recorded approximately \$8 million in restructuring charges, primarily related to severance and benefit costs associated with restructuring of its corporate operations, \$6 million of which remained payable as of March 29, 2014. As of June 28, 2014, the remaining restructuring liability related to these charges was \$4 million, which is expected to be paid by the end of fiscal year 2015.

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Income Taxes

Effective Tax Rate

The Company's effective tax rate, which is calculated by dividing the provision for income taxes by pretax income, was 31.1% and 31.7% during the three-month periods ended June 28, 2014 and June 29, 2013, respectively. The Company's effective tax rate differs from the statutory rate due to the effect of state and local taxes, tax rates in foreign jurisdictions, and certain nondeductible expenses. The effective tax rate in both periods was lower than the U.S. federal statutory income tax rate of 35% principally as a result of the effect of earnings generated in lower taxed foreign jurisdictions. In addition, the effective tax rate for the three months ended June 28, 2014 was favorably impacted by an income tax benefit resulting from the legal entity restructuring of certain of the Company's foreign operations during Fiscal 2015, partially offset by additional tax reserves associated with the conclusion of tax examinations.

Uncertain Income Tax Benefits

Reconciliations of the beginning and ending amounts of unrecognized tax benefits, excluding interest and penalties, for the three-month periods ended June 28, 2014 and June 29, 2013 are presented below:

	Three Months Ended	
	June 28, 2014	June 29, 2013
	(millions)	
Unrecognized tax benefits beginning balance	\$83	\$100
Additions related to current period tax positions	1	1
Additions related to prior period tax positions	4	1
Reductions related to prior period tax positions	(1	) (2
Reductions related to settlements with taxing authorities	(1) —
Changes related to foreign currency translation	—	1
Unrecognized tax benefits ending balance	\$86	\$101

The Company classifies interest and penalties related to unrecognized tax benefits as part of its provision for income taxes. Reconciliations of the beginning and ending amounts of accrued interest and penalties related to unrecognized tax benefits for the three-month periods ended June 28, 2014 and June 29, 2013 are presented below:

	Three Months Ended	
	June 28, 2014	June 29, 2013
	(millions)	
Accrued interest and penalties beginning balance	\$49	\$50
Net additions charged to expense	2	1
Reductions related to prior period tax positions	(1	) (1
Accrued interest and penalties ending balance	\$50	\$50

The total amount of unrecognized tax benefits, including interest and penalties, was \$136 million and \$132 million as of June 28, 2014 and March 29, 2014, respectively, and is included within non-current liability for unrecognized tax benefits in the consolidated balance sheets. The total amount of unrecognized tax benefits that, if recognized, would affect the Company's effective tax rate was \$89 million and \$86 million as of June 28, 2014 and March 29, 2014, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Future Changes in Unrecognized Tax Benefits

The total amount of unrecognized tax benefits relating to the Company's tax positions is subject to change based on future events including, but not limited to, the settlements of ongoing tax audits and assessments and the expiration of applicable statutes of limitations. Although the outcomes and timing of such events are highly uncertain, the Company does not anticipate that the balance of gross unrecognized tax benefits, excluding interest and penalties, will change significantly during the next twelve months. However, changes in the occurrence, expected outcomes, and timing of such events could cause the Company's current estimate to change materially in the future.

The Company files a consolidated U.S. federal income tax return, as well as tax returns in various state, local, and foreign jurisdictions. The Company is generally no longer subject to examinations by the relevant tax authorities for years prior to fiscal year 2006.

11. Debt

Senior Notes

In September 2013, the Company completed a registered public debt offering and issued \$300 million aggregate principal amount of unsecured senior notes due September 26, 2018 (the "Senior Notes") at a price equal to 99.896% of their principal amount. The Senior Notes bear interest at a fixed rate of 2.125%, payable semi-annually. The proceeds from this offering were used for general corporate purposes, including the repayment of the Company's €209 million principal amount previously outstanding of 4.5% Euro-denominated notes (the "Euro Debt"), which matured on October 4, 2013.

The Company has the option to redeem the Senior Notes, in whole or in part, at any time at a price equal to accrued interest on the redemption date, plus the greater of (i) 100% of the principal amount of Senior Notes to be redeemed or (ii) the sum of the present value of Remaining Scheduled Payments, as defined in the indenture governing the Senior Notes (the "Indenture"). The Indenture contains certain covenants that restrict the Company's ability, subject to specified exceptions, to incur certain liens; enter into sale and leaseback transactions; consolidate or merge with another party; or sell, lease, or convey all or substantially all of the Company's property or assets to another party. However, the Indenture does not contain any financial covenants.

Commercial Paper

In May 2014, the Company initiated a commercial paper borrowing program (the "Commercial Paper Program") that allows it to issue up to \$300 million of unsecured commercial paper notes through private placement using third-party broker-dealers. Borrowings under the Commercial Paper Program are supported by the Global Credit Facility, as defined below, and may be used for the Company's general working capital and corporate needs. Maturities of commercial paper notes will vary depending upon needs, but cannot exceed 397 days from the date of issuance. Commercial paper issued under the Commercial Paper Program will rank equally with the Company's other unsecured indebtedness. As of June 28, 2014, there were no borrowings under the Company's Commercial Paper Program.

Revolving Credit Facilities

Global Credit Facility

The Company has a credit facility that provides for a \$500 million senior unsecured revolving line of credit through March 2016, which may also be used to support the issuance of letters of credit and the maintenance of the Commercial Paper Program (the "Global Credit Facility"). Borrowings under the Global Credit Facility may be denominated in U.S. Dollars and other currencies, including Euros, Hong Kong Dollars, and Japanese Yen. The Company has the ability to expand its borrowing availability under the Global Credit Facility to \$750 million, subject to the agreement of one or more new or existing lenders under the facility to increase their commitments. There are no mandatory reductions in borrowing ability throughout the term of the Global Credit Facility. As of June 28, 2014, there were no borrowings outstanding under the Global Credit Facility and the Company was contingently liable for \$9 million of outstanding letters of credit.

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Global Credit Facility contains a number of covenants that, among other things, restrict the Company's ability, subject to specified exceptions, to incur additional debt; incur liens; sell or dispose of assets; merge with or acquire other companies; liquidate or dissolve itself; engage in businesses that are not in a related line of business; make loans, advances, or guarantees; engage in transactions with affiliates; and make certain investments. The Global Credit Facility also requires the Company to maintain a maximum ratio of Adjusted Debt to Consolidated EBITDAR (the "leverage ratio") of no greater than 3.75 as of the date of measurement for the four most recent consecutive fiscal quarters. Adjusted Debt is defined generally as consolidated debt outstanding plus eight times consolidated rent expense for the last four consecutive fiscal quarters. Consolidated EBITDAR is defined generally as consolidated net income plus (i) income tax expense, (ii) net interest expense, (iii) depreciation and amortization expense, and (iv) consolidated rent expense. As of June 28, 2014, no Event of Default (as such term is defined pursuant to the Global Credit Facility) has occurred under the Company's Global Credit Facility.

Pan-Asia Credit Facilities

Certain of the Company's subsidiaries in Asia have uncommitted credit facilities with regional branches of JPMorgan Chase (the "Banks") in China, Malaysia, South Korea, and Taiwan (the "Pan-Asia Credit Facilities"). These credit facilities are subject to annual renewal and may be used to fund general working capital and corporate needs of the Company's operations in the respective countries. Borrowings under the Pan-Asia Credit Facilities are guaranteed by the parent company and are granted at the sole discretion of the Banks, subject to availability of the Banks' funds and satisfaction of certain regulatory requirements. The Pan-Asia Credit Facilities do not contain any financial covenants. The Company's Pan-Asia Credit Facilities by country are as follows:

- China Credit Facility — provides Ralph Lauren Trading (Shanghai) Co., Ltd. with a revolving line of credit of up to 100 million Chinese Renminbi (approximately \$16 million) through April 8, 2015, and may also be used to support bank guarantees. As of June 28, 2014, bank guarantees of 12 million Chinese Renminbi (approximately \$2 million) were supported by this facility.
- Malaysia Credit Facility — provides Ralph Lauren (Malaysia) Sdn Bhd with a revolving line of credit of up to 16 million Malaysian Ringgit (approximately \$5 million) through September 17, 2014.
- South Korea Credit Facility — provides Ralph Lauren (Korea) Ltd. with a revolving line of credit of up to 11 billion South Korean Won (approximately \$11 million) through October 31, 2014.
- Taiwan Credit Facility — provides Ralph Lauren (Hong Kong) Retail Company Limited, Taiwan Branch with a revolving line of credit of up to 59 million New Taiwan Dollars (approximately \$2 million) through October 15, 2014. As of June 28, 2014, there were no borrowings outstanding under any of the Pan-Asia Credit Facilities. Refer to Note 14 of the Fiscal 2014 10-K for additional disclosure of the terms and conditions of the Company's debt and credit facilities.

12. Fair Value Measurements

U.S. GAAP establishes a three-level valuation hierarchy for disclosure of fair value measurements. The determination of the applicable level within the hierarchy for a particular asset or liability depends on the inputs used in its valuation as of the measurement date, notably the extent to which the inputs are market-based (observable) or internally-derived (unobservable). A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows:

• Level 1 — inputs to the valuation methodology based on quoted prices (unadjusted) for identical assets or liabilities in active markets.

• Level 2 — inputs to the valuation methodology based on quoted prices for similar assets and liabilities in active markets for substantially the full term of the financial instrument; quoted prices for identical or similar instruments

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

in markets that are not active for substantially the full term of the financial instrument; and model-derived valuations whose inputs or significant value drivers are observable.

Level 3 — inputs to the valuation methodology based on unobservable prices or valuation techniques that are significant to the fair value measurement.

The following table summarizes the Company's financial assets and liabilities that are measured and recorded at fair value on a recurring basis:

	June 28, 2014 (millions)	March 29, 2014
Financial assets recorded at fair value:		
Government bonds ^(a)	\$—	\$ 1
Auction rate securities ^(b)	2	2
Derivative financial instruments ^(b)	7	8
Total	\$9	\$ 11
Financial liabilities recorded at fair value:		
Derivative financial instruments ^(b)	\$8	\$7
Total	\$8	\$7

^(a) Based on Level 1 measurements.

^(b) Based on Level 2 measurements.

To the extent the Company invests in bonds, such investments are classified as available-for-sale and recorded at fair value in its consolidated balance sheets based upon quoted prices in active markets.

The Company's auction rate securities are classified as available-for-sale and recorded at fair value within other non-current assets in its consolidated balance sheets. Third-party pricing institutions may value auction rate securities at par, which may not necessarily reflect prices that would be obtained if sold in the current market. When quoted market prices are unobservable, fair value is estimated based on a number of known factors and external pricing data, including known maturity dates, the coupon rate based upon the most recent reset market clearing rate, the price/yield representing the average rate of recent successfully traded securities, and the total principal balance of each security.

The Company's derivative financial instruments are recorded at fair value in its consolidated balance sheets on a gross basis and are valued using a pricing model, which is primarily based on market observable external inputs, including forward and spot exchange rates for foreign currencies, and considers the impact of the Company's own credit risk, if any. Changes in counterparty credit risk are also considered in the valuation of derivative financial instruments.

The Company's cash and cash equivalents, restricted cash, and time deposits are recorded at carrying value, which approximates fair value based on Level 1 measurements.

The Company's debt is recorded at carrying value in its consolidated balance sheets, which may differ from its fair value. The carrying value of the Senior Notes is adjusted for any unamortized discount, which is not material. The fair value of the Senior Notes is estimated based on external pricing data, including available quoted market prices, and of comparable debt instruments with similar interest rates, credit ratings, and trading frequency, among other factors.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the carrying values and the estimated fair values of the Company's Senior Notes:

	June 28, 2014		March 29, 2014	
	Carrying Value (millions)	Fair Value ^(a)	Carrying Value	Fair Value ^(a)
2.125% Senior Notes	\$300	\$303	\$300	\$300

^(a) Based on Level 2 measurements.

Unrealized gains or losses on the Company's debt do not result in the realization or expenditure of cash, unless the debt is retired prior to its maturity.

Non-financial Assets and Liabilities

The Company's non-financial assets, which primarily consist of goodwill, other intangible assets, and property and equipment, are not required to be measured at fair value on a recurring basis and are reported at carrying value.

However, on a periodic basis or whenever events or changes in circumstances indicate that their carrying value may not be fully recoverable (and at least annually for goodwill and indefinite-lived intangible assets), non-financial instruments are assessed for impairment and, if applicable, written-down to and recorded at fair value, considering external market participant assumptions. There were no material impairment charges recorded during either of the three-month periods ended June 28, 2014 and June 29, 2013.

13. Financial Instruments

Derivative Financial Instruments

The Company is exposed to changes in foreign currency exchange rates, primarily relating to certain anticipated cash flows of its international operations. Consequently, the Company uses derivative financial instruments to manage such risks. The Company does not enter into derivative transactions for speculative or trading purposes.

The following table summarizes the Company's outstanding derivative instruments on a gross basis as recorded in the consolidated balance sheets as of June 28, 2014 and March 29, 2014:

Derivative Instrument ^(a)	Notional Amounts		Derivative Assets				Derivative Liabilities							
	June 28, 2014	March 29, 2014	June 28, 2014	Balance Sheet Line ^(b)	Fair Value	March 29, 2014	Balance Sheet Line ^(b)	Fair Value	June 28, 2014	Balance Sheet Line ^(b)	Fair Value	March 29, 2014	Balance Sheet Line ^(b)	Fair Value
	(millions)													
Designated Hedges:														
FC — Inventory purchases	\$501	\$476	(c)	\$4	(d)	\$2	AE	\$4	AE	\$5				
FC — Other	210	223	—	—	—	—	AE	3	AE	2				
Total Designated Hedges	\$711	\$699		\$4		\$2								