RALPH LAUREN CORP
Form 10-Q
November 02, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 29, 2012

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)*	**13-2622036** *(I.R.S. Employer* *Identification No.)*
650 Madison Avenue, **New York, New York** *(Address of principal executive offices)*	**10022** *(Zip Code)*

(212) 318-7000

(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 þ 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 þ 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	þ	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 þ

At October 26, 2012, 60,653,730 shares of the registrant s Class A common stock, $.01 par value, and 30,831,276 shares of the registrant s Class B common stock, $.01 par value, were outstanding.

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CONSOLIDATED BALANCE SHEETS

	September 29, 2012	March 31, 2012
	(millions) (unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 543.7	$ 671.6
Short-term investments	469.1	515.7
Accounts receivable, net of allowances of $267.6 million and $262.7 million	606.8	547.2
Inventories	1,060.2	841.6
Income tax receivable	22.2	17.2
Deferred tax assets	123.5	125.6
Prepaid expenses and other	177.5	181.0
Total current assets	3,003.0	2,899.9
Non-current investments	84.9	99.9
Property and equipment, net	911.9	884.1
Deferred tax assets	34.8	39.8
Goodwill	1,014.0	1,004.0
Intangible assets, net	349.7	359.0
Other assets	125.2	129.7
Total assets	$ 5,523.5	$ 5,416.4
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$ 224.4	$ 180.6
Income tax payable	35.1	71.9
Accrued expenses and other	698.6	693.7
Total current liabilities	958.1	946.2
Long-term debt	265.8	274.4
Non-current liability for unrecognized tax benefits	186.5	168.0
Other non-current liabilities	376.7	375.3
Commitments and contingencies (Note 12)		
Total liabilities	1,787.1	1,763.9
Equity:		
Class A common stock, par value $.01 per share; 92.3 million and 91.1 million shares issued; 60.7 million and 61.9 million shares outstanding	0.9	0.9
Class B common stock, par value $.01 per share; 30.8 million shares issued and outstanding	0.3	0.3
Additional paid-in-capital	1,719.6	1,624.0
Retained earnings	4,376.5	4,042.4
Treasury stock, Class A, at cost (31.6 million and 29.2 million shares)	(2,558.4)	(2,211.7)
Accumulated other comprehensive income	197.5	196.6
Total equity	3,736.4	3,652.5

Total liabilities and equity	$ 5,523.5	$ 5,416.4

See accompanying notes.

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RALPH LAUREN CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(millions, except per share data) (unaudited)			
Net sales	$ 1,815.4	$ 1,856.8	$ 3,366.8	$ 3,343.3
Licensing revenue	46.6	47.8	88.6	87.7
Net revenues	1,862.0	1,904.6	3,455.4	3,431.0
Cost of goods sold[a]	(766.7)	(826.0)	(1,368.0)	(1,390.9)
Gross profit	1,095.3	1,078.6	2,087.4	2,040.1
Other costs and expenses:				
Selling, general and administrative expenses[a]	(740.2)	(720.3)	(1,433.6)	(1,392.6)
Amortization of intangible assets	(6.8)	(7.5)	(13.5)	(14.6)
Total other costs and expenses	(747.0)	(727.8)	(1,447.1)	(1,407.2)
Operating income	348.3	350.8	640.3	632.9
Foreign currency gains (losses)	(0.5)	1.8	(3.1)	(2.0)
Interest expense	(5.4)	(6.4)	(10.9)	(12.5)
Interest and other income, net	1.3	2.4	2.6	6.6
Equity in income (loss) of equity-method investees	(1.5)	(1.1)	(2.8)	(3.0)
Income before provision for income taxes	342.2	347.5	626.1	622.0
Provision for income taxes	(128.5)	(114.0)	(219.0)	(204.4)
Net income attributable to RLC	$ 213.7	$ 233.5	$ 407.1	$ 417.6
Net income per common share attributable to RLC:				
Basic	$ 2.34	$ 2.53	$ 4.44	$ 4.49
Diluted	$ 2.29	$ 2.46	$ 4.32	$ 4.35
Weighted average common shares outstanding:				
Basic	91.3	92.2	91.7	93.1
Diluted	93.4	94.9	94.2	95.9
Dividends declared per share	$ 0.40	$ 0.20	$ 0.80	$ 0.40
[a] Includes total depreciation expense of:	$ (50.5)	$ (48.5)	$ (99.9)	$ (96.8)

See accompanying notes.

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended		Six Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(millions) (unaudited)			
Net income attributable to RLC	$ 213.7	$ 233.5	$ 407.1	$ 417.6
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	42.2	(25.7)	0.9	6.7
Net realized and unrealized gains (losses) on derivatives	(9.2)	33.5	(3.3)	25.4
Net realized and unrealized gains (losses) on available-for-sale investments	3.5	(0.1)	3.6	(0.1)
Net realized and unrealized gains (losses) on defined benefit plans	(0.4)	(0.3)	(0.3)	(0.4)
Other comprehensive income, net of tax	36.1	7.4	0.9	31.6
Total comprehensive income attributable to RLC	$ 249.8	$ 240.9	$ 408.0	$ 449.2

See accompanying notes.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended September 29, 2012	Six Months Ended October 1, 2011
	(millions) (unaudited)	
Cash flows from operating activities:		
Net income	$ 407.1	$ 417.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	113.4	111.4
Deferred income tax expense (benefit)	5.3	(13.7)
Equity in loss of equity-method investees, net of dividends received	2.8	3.0
Non-cash stock-based compensation expense	42.8	34.0
Excess tax benefits from stock-based compensation arrangements	(26.4)	(21.2)
Other non-cash charges (benefits), net	(1.4)	0.6
Changes in operating assets and liabilities:		
Accounts receivable	(55.8)	(195.8)
Inventories	(215.8)	(284.4)
Accounts payable and accrued liabilities	36.6	32.7
Income tax receivables and payables	(10.3)	184.9
Deferred income	(15.8)	(8.6)
Other balance sheet changes	24.2	23.0
Net cash provided by operating activities	306.7	283.5
Cash flows from investing activities:		
Acquisitions and ventures, net of cash acquired and purchase price settlements	(9.9)	(7.9)
Purchases of investments	(609.1)	(792.9)
Proceeds from sales and maturities of investments	647.6	880.3
Capital expenditures	(117.3)	(92.4)
Change in restricted cash deposits	7.1	0.3
Net cash used in investing activities	(81.6)	(12.6)
Cash flows from financing activities:		
Proceeds from credit facilities		107.7
Repayments of borrowings on credit facilities		(7.7)
Payments of capital lease obligations	(4.6)	(4.2)
Payments of dividends	(55.0)	(37.4)
Repurchases of common stock, including shares surrendered for tax withholdings	(346.7)	(417.8)
Proceeds from exercise of stock options	26.4	29.5
Excess tax benefits from stock-based compensation arrangements	26.4	21.2
Payment on interest rate swap termination		(7.6)
Other financing activities		0.2
Net cash used in financing activities	(353.5)	(316.1)
Effect of exchange rate changes on cash and cash equivalents	0.5	(0.1)
Net decrease in cash and cash equivalents	(127.9)	(45.3)
Cash and cash equivalents at beginning of period	671.6	453.0

Cash and cash equivalents at end of period	$ 543.7	$ 407.7

See accompanying notes.

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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 (including footwear), fragrances and home furnishings. RLC s long-standing reputation and distinctive image have been consistently developed across an expanding number of products, brands and international markets. RLC s brand names include *Polo Ralph Lauren, Purple Label, Ralph Lauren Women s Collection, Black Label, Blue Label, Lauren by Ralph Lauren, RRL, RLX Ralph Lauren, Denim & Supply Ralph Lauren, Rugby, Ralph Lauren, Ralph Lauren Childrenswear, American Living, Chaps* and *Club Monaco*, among others. RLC and its subsidiaries are collectively referred to herein as the Company, we, us, our and ourselves, unless the co 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 located throughout North America, Europe, Asia and South America. The Company also sells directly to consumers through retail stores located throughout North America, Europe, Asia and South America; through concessions-based shop-within-shops located primarily in Asia and Europe; and through its retail e-commerce channel in North America, Europe and Asia. The Company also licenses the right to unrelated third parties 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, in specified geographical areas for specified periods.

2. Basis of Presentation

Interim Financial Statements

The interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). The interim consolidated financial statements are unaudited. In the opinion of management, however, such consolidated financial statements contain all normal and recurring adjustments necessary to present fairly the consolidated financial condition, results of operations, comprehensive income and changes in 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. (US 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 herein are adequate to make the information presented not misleading.

The consolidated balance sheet data as of March 31, 2012 is derived from the audited consolidated financial statements included in the Company s Annual Report on Form 10-K filed with the SEC for the fiscal year ended March 31, 2012 (the Fiscal 2012 10-K), which should be read in conjunction with these unaudited interim consolidated financial statements. Reference is made to the Fiscal 2012 10-K for a complete set of financial statements.

Basis of Consolidation

The unaudited interim consolidated financial statements present the financial position, results of operations, 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fiscal Year

The Company utilizes a 52-53 week fiscal year ending on the Saturday closest to March 31. As such, fiscal year 2013 will end on March 30, 2013 and will be a 52-week period (Fiscal 2013). Fiscal year 2012 ended on March 31, 2012 and also reflected a 52-week period (Fiscal 2012). Accordingly, the second quarter of Fiscal 2013 ended on September 29, 2012 and was a 13-week period. The second quarter of Fiscal 2012 ended on October 1, 2011 and was also a 13-week period.

Use of Estimates

The preparation of financial statements in conformity with US 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.

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 and related expected forfeiture rates; reserves for restructuring; and accounting for business combinations.

Reclassifications

Certain reclassifications have been made to the prior periods financial information in order to conform to the current period s presentation.

Seasonality of Business

The Company s business is typically affected by seasonal trends, with higher levels of wholesale sales generated in its second and fourth quarters and higher retail sales generated 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 influenced 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 and six-month periods ended September 29, 2012 are not necessarily indicative of the results and cash flows that may be expected for the full Fiscal 2013.

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, 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 allowances, 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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 concessions-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 retail Internet sites is recognized upon delivery and receipt of the shipment by 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 a gift card being redeemed 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 (a) contractually guaranteed minimum royalty levels or (b) actual sales and royalty data, or estimates thereof, received from the Company s licensees.

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

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 consolidated statements of operations. Shipping costs were $9.6 million and $17.2 million during the three-month and six-month periods ended September 29, 2012, respectively, and $10.1 million and $18.3 million during the three-month and six-month periods ended October 1, 2011, 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 $38.4 million and $74.2 million during the three-month and six-month periods ended September 29, 2012, respectively, and $35.0 million and $65.5 million during the three-month and six-month periods ended October 1, 2011, 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 the net income applicable to common shares after preferred dividend requirements, if any, 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 and any other potentially dilutive financial instruments, only in the periods in which such effect is dilutive under the treasury stock method.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Three Months Ended		Six Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(millions)			
Basic	91.3	92.2	91.7	93.1
Dilutive effect of stock options, restricted stock and restricted stock units	2.1	2.7	2.5	2.8
Diluted shares	93.4	94.9	94.2	95.9

Options to purchase shares of 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 restricted stock units that are issuable only upon the achievement of certain service and/or performance goals. Performance-based restricted stock units are included in the computation of diluted shares only to the extent that the underlying performance conditions (a) are satisfied as of the end of the reporting period or (b) would be 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 September 29, 2012 and October 1, 2011, there was an aggregate of approximately 1.3 million and 0.7 million, respectively, of additional shares issuable as of the end of each period upon the exercise of anti-dilutive options and the contingent vesting of performance-based restricted stock units that 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 (a) reserves for returns, discounts, end-of-season markdowns and operational chargebacks (see *Revenue Recognition* for further discussion of related accounting policies) and (b) allowances for doubtful accounts.

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

	Three Months Ended		Six Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(millions)			
Beginning reserve balance	$ 227.7	$ 197.1	$ 246.7	$ 213.2
Amount charged against revenue to increase reserve	191.3	169.1	329.3	282.1
Amount credited against customer accounts to decrease reserve	(172.1)	(129.9)	(323.4)	(261.7)
Foreign currency translation	4.2	(5.3)	(1.5)	(2.6)
Ending reserve balance	$ 251.1	$ 231.0	$ 251.1	$ 231.0

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

A rollforward of the activity in the Company s allowance for doubtful accounts is presented below:

	Three Months Ended		Six Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(millions)			
Beginning reserve balance	$ 15.8	$ 17.7	$ 16.0	$ 17.7
Amount recorded to expense to increase reserve[(a)]	0.8	0.6	1.8	0.9
Amount written off against customer accounts to decrease reserve	(0.5)	(0.5)	(1.1)	(1.1)
Foreign currency translation	0.4	(0.6)	(0.2)	(0.3)
Ending reserve balance	$ 16.5	$ 17.2	$ 16.5	$ 17.2

(a) Amounts recorded to bad debt expense are included within SG&A expenses in the unaudited interim consolidated statements of operations.

Concentration of Credit Risk

The Company sells its wholesale merchandise primarily to major department and specialty stores across North America, Europe, Asia and South America, 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. For Fiscal 2012, these customers in the aggregate contributed approximately 40% of all Wholesale revenues. Further, as of September 29, 2012, the Company s three key wholesale customers represented approximately 30% of gross accounts receivable.

Derivative Financial Instruments

The Company records all derivative instruments on the consolidated balance sheets at fair value. In addition, for derivative instruments that qualify for hedge accounting, the effective portion of changes in their fair value is either (a) offset against the changes in fair value of the hedged assets, liabilities or firm commitments through earnings or (b) recognized in equity as a component of accumulated other comprehensive income (loss) (AOCI) until the hedged item is recognized in earnings, depending on whether the derivative is being used to hedge changes in fair value or cash flows, respectively.

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

RALPH LAUREN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

To the extent that a derivative contract designated as a cash flow hedge is not considered to be effective, any changes in fair value relating to the ineffective portion are immediately recognized in earnings within foreign currency gains (losses). If it is determined that a derivative has not been highly effective, and will continue not to be highly effective at hedging the designated exposure, hedge accounting is discontinued. If a hedge relationship is terminated, the change in fair value of the derivative previously recorded in AOCI is recognized when the 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 counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the 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 financial factors, adhering to established limits for credit exposure. The Company s established policies and procedures for mitigating credit risk from derivative transactions include continually reviewing and assessing 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, which in certain instances allow the Company to net settle amounts owed under multiple derivative transactions with the same counterparty. However, 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.

Forward Foreign Currency Exchange Contracts

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

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

Interest Payments on Euro Debt Recognized within foreign currency gains (losses) in the period in which the recorded liability impacts earnings due to foreign currency exchange remeasurement.

Hedge of a Net Investment in a Foreign Operation

Changes in the fair value of a derivative instrument or a non-derivative financial instrument (such as debt) that is designated as a hedge of a net investment in a foreign operation are reported in the same manner as a translation adjustment to the extent it is effective as a hedge. In assessing the effectiveness of a non-derivative

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

financial instrument that has been designated as a hedge of a net investment, the Company uses the spot rate method of accounting to value foreign currency exchange rate changes in both its foreign subsidiaries and the financial instrument. If the notional amount of the financial instrument designated as a hedge of a net investment is greater than the portion of the net investment being hedged, hedge ineffectiveness is recognized immediately in earnings within foreign currency gains (losses). To the extent the financial instrument remains effective, changes in its fair value are recorded in equity as a component of AOCI until the sale or liquidation of the hedged net investment.

Undesignated Hedges

All of the Company s undesignated hedges are entered into to hedge specific economic risks, such as 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 11 for further discussion of the Company s derivative financial instruments.

For a summary of all of the Company s significant accounting policies, refer to Note 3 to the audited consolidated financial statements included in the Company s Fiscal 2012 10-K.

4. Recently Issued Accounting Standards

Disclosure of Offsetting Assets and Liabilities

In December 2011, the Financial Accounting Standards Board (FASB) issued new, expanded disclosure requirements for financial instruments surrounding an entity s rights of offset and related counterparty arrangements as Accounting Standards Update (ASU) No. 2011-11, Disclosures about Offsetting Assets and Liabilities (ASU 2011-11). ASU 2011-11 requires disclosure of both gross and net information for recognized financial instruments (including derivatives) that are (i) eligible for offset and presented net in the balance sheet or (ii) subject to enforceable master netting agreements, irrespective of whether an entity actually offsets and net presents such instruments in the balance sheet. ASU 2011-11 also requires disclosure of any collateral received or posted in connection with master netting agreements or similar arrangements. ASU 2011-11 requires retrospective application, and is effective for the Company as of the beginning of Fiscal 2014. The application of ASU 2011-11 is expected to expand the Company s quarterly and annual financial instrument disclosures, but will not have an impact on its consolidated financial statements.

Goodwill Impairment Testing

In September 2011, the FASB issued revised guidance for goodwill impairment testing as ASU No. 2011-08, Testing Goodwill for Impairment (ASU 2011-08). ASU 2011-08 simplifies goodwill impairment testing by providing entities with the option of performing a qualitative assessment to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount. The results of such assessment may be used as a basis for determining whether it is necessary to perform the two-step quantitative impairment test required under Accounting Standards Codification (ASC) topic 350, Intangibles Goodwill and Other. ASU 2011-08 is effective for the Company s Fiscal 2013 annual goodwill impairment testing, which was performed during the second fiscal quarter using the qualitative assessment approach prescribed by the standard. The application of ASU 2011-08 did not have an impact on the Company s consolidated financial statements.

RALPH LAUREN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Presentation of Comprehensive Income

In June 2011, the FASB issued revised guidance on the presentation of comprehensive income as ASU No. 2011-05, Comprehensive Income: Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 eliminates the option to present the components of other comprehensive income (OCI) as part of the consolidated statement of equity and provides two alternatives for presenting the components of net income and OCI, either: (i) in a single continuous statement of comprehensive income or (ii) in two separate but consecutive financial statements, consisting of an income statement followed by a separate statement of comprehensive income. Additionally, this guidance requires items that are reclassified from AOCI to net income to be presented on the face of the financial statements. However, in December 2011, the FASB issued ASU No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05, which deferred this requirement until the conclusion of further deliberations. The Company adopted the provisions of ASU 2011-05 during Fiscal 2013, which resulted in the inclusion of separate statements of comprehensive income for all periods presented within its consolidated financial statements beginning in the first quarter.

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 August 2010, 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 all leases, including existing and new arrangements, would be recognized as assets and liabilities, respectively, on the balance sheet. Subsequent to the end of the related comment period, the FASB made several amendments to the Exposure Draft, including (i) revising the definition of the lease term to include the non-cancelable lease term plus only those option periods for which there is significant economic incentive for the lessee to extend or not terminate the lease; (ii) redefining the initial lease liability to be recorded on the Company s balance sheet to contemplate only those variable lease payments that are in substance fixed ; and (iii) developing a principle to determine whether lease expense will be recognized on a straight-line or accelerated basis, which considers the nature of the underlying leased asset. The FASB continues to deliberate on this matter and currently plans to issue a revised exposure draft for comment in the first half of calendar 2013. If effective as currently planned, 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 will have on its consolidated financial statements.

5. Inventories

Inventories consist of the following:

	September 29, 2012	March 31, 2012	October 1, 2011
		(millions)	
Raw materials	$ 5.2	$ 5.1	$ 6.1
Work-in-process	1.1	1.1	1.1
Finished goods	1,053.9	835.4	981.2
Total inventories	$ 1,060.2	$ 841.6	$ 988.4

RALPH LAUREN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Property and Equipment

Property and equipment, net, consists of the following:

	September 29, 2012	March 31, 2012
	(millions)	
Land and improvements	$ 9.9	$ 9.9
Buildings and improvements	117.6	115.9
Furniture and fixtures	590.7	561.8
Machinery and equipment	174.8	157.4
Capitalized software	242.2	213.6
Leasehold improvements	945.6	915.0
Construction in progress	94.9	84.9
	2,175.7	2,058.5
Less: accumulated depreciation	(1,263.8)	(1,174.4)
Property and equipment, net	$ 911.9	$ 884.1

7. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

	September 29, 2012	March 31, 2012
	(millions)	
Accrued operating expenses	$ 172.4	$ 175.7
Accrued payroll and benefits	145.6	227.7
Accrued inventory	152.8	108.0
Accrued capital expenditures	56.7	45.4
Deferred income	44.9	50.3
Other taxes payable	62.0	47.1
Other accrued expenses and current liabilities	64.2	39.5
Total accrued expenses and other current liabilities	$ 698.6	$ 693.7

8. Income Taxes

Uncertain Income Tax Benefits

A reconciliation of the beginning and ending amounts of unrecognized tax benefits, excluding interest and penalties, for the three-month and six-month periods ended September 29, 2012 and October 1, 2011 is presented below:

	Three Months Ended		Six Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(millions)			
Unrecognized tax benefits beginning balance	$ 126.1	$ 127.0	$ 129.0	$ 125.0
Additions related to current period tax positions	0.8	0.9	1.6	1.9
Additions related to prior period tax positions	1.4	0.1	1.6	0.2
Reductions related to prior period tax positions	(0.3)	(0.3)	(1.5)	(0.7)
Additions (reductions) related to foreign currency translation	1.5	(2.9)	(1.2)	(1.6)
Unrecognized tax benefits ending balance	$ 129.5	$ 124.8	$ 129.5	$ 124.8

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company classifies interest and penalties related to unrecognized tax benefits as part of its provision for income taxes. A reconciliation of the beginning and ending amounts of accrued interest and penalties related to unrecognized tax benefits for the three-month and six-month periods ended September 29, 2012 and October 1, 2011 is presented below:

	Three Months Ended		Six Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(millions)			
Accrued interest and penalties beginning balance	$ 38.1	$ 33.8	$ 39.0	$ 31.4
Net additions charged to expense	18.5[(a)]	2.1	20.0[(a)]	4.1
Reductions related to prior period tax positions			(2.1)	
Additions (reductions) related to foreign currency translation	0.4	(0.5)	0.1	(0.1)
Accrued interest and penalties ending balance	$ 57.0	$ 35.4	$ 57.0	$ 35.4

(a) Includes a reserve of $16.8 million for an interest assessment on a prior year withholding tax. No underlying tax exposure exists. The interest assessed was not material to the Company s consolidated financial statements in any prior or current fiscal period, and is not expected to be material for the full Fiscal 2013.

The total amount of unrecognized tax benefits, including interest and penalties, was $186.5 million as of September 29, 2012 and $168.0 million as of March 31, 2012, 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 $136.9 million as of September 29, 2012.

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, it is reasonably possible that the balance of gross unrecognized tax benefits, excluding interest and penalties, could potentially be reduced by up to approximately $30 million during the next 12 months. However, changes in the occurrence, expected outcomes and timing of those events could cause the Company s current estimate to change materially in the future.

The Company files tax returns in the U.S. federal and various state, local and foreign jurisdictions. With few exceptions for those tax returns, the Company is no longer subject to examinations by the relevant tax authorities for years prior to Fiscal 2004.

See Note 17 for a description of a tax audit settlement that occurred subsequent to the end of the second quarter of Fiscal 2013, in October 2012.

9. Debt

Euro Debt

As of September 29, 2012, the Company had outstanding 209.2 million principal amount of 4.5% notes due October 4, 2013 (the Euro Debt). The Company has the option to redeem all of the outstanding Euro Debt at any time at a redemption price equal to the principal amount plus a premium. The Company also has the option to redeem all of the outstanding Euro Debt at any time at par plus accrued interest in the event of certain

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RALPH LAUREN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

developments involving U.S. tax law. Partial redemption of the Euro Debt is not permitted in either instance. In the event of a change of control of the Company, each holder of the Euro Debt has the option to require the Company to redeem the Euro Debt at its principal amount plus accrued interest. The indenture governing the Euro Debt (the Indenture) contains certain limited covenants that restrict the Company s ability, subject to specified exceptions, to incur liens or enter into a sale and leaseback transaction for any principal property. The Indenture does not contain any financial covenants.

As of September 29, 2012, the carrying value of the Euro Debt was $265.8 million, compared to $274.4 million as of March 31, 2012.

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, also used to support the issuance of letters of credit (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 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 September 29, 2012, there were no borrowings outstanding under the Global Credit Facility and the Company was contingently