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ANALYST QUICK NOTES

New products, M&A announcements, management shakeups, earnings surprises. Whatever the news, you want to know what Argus thinks. Our Quick Notes fill this need by providing real-time analysis of current news about Argus-covered companies or other market-moving events. Please check back regularly for new Quick Notes. Important disclaimer information is on the last page of this document.

Genuine Parts Co. (NYSE: GPC: HOLD)
Target Price: $NA
Bill Selesky
4/27/2015

Event: A recap of Genuine Parts 1Q15 results

Results

- 1Q15 revenue of $3.74 billion versus $3.62 billion in 1Q14 (up 3%)
- 1Q15 earnings per share of $1.05 versus $1.02 in 1Q14 (up 3%)
- Comp-store sales in Automotive of 3% in 1Q15 versus 2% in 1Q14

Our Takeaways

- While GPC's posted in-line results, the Automotive segment stayed strong
- Comp-store sales growth in Automotive at healthy 3%
- GPC experienced higher average ticket and number of tickets
- Results were evenly spread geographically among store base

Recommendation

- GPC is not a pure-play auto-parts retailer
- We prefer the pure-plays
- Recommend AutoZone (AZO) & Pep Boys (PBY)

Coach Inc. (NYSE: COH: HOLD)
Target Price: $NA
Chris Graja, CFA
4/27/2015

Earnings Preview and Roadmap

- What it would take for us to become more positive on the Coach shares?
- Coach will report 3Q earnings before the market opens on April 28.
  - Management is scheduled to host a conference call at 8:30 a.m.
    - 1-888-405-2080

The Key to the Call

- The promotional environment for handbags.
  - Whether greater discounting is needed stop the loss of market share.
- We will be interested in management's market share data for the quarter.
- Comments about the ongoing response of shoppers to Stuart Vevers's merchandise transformation.
  - Comments on stores with an expanded product line.

Some Key Stats

- The shares have significantly underperformed over the last year, falling 12% on a total-return basis versus a 15% gain for the S&P 500.
  - Sales have missed consensus projections in four of the last six quarters, though earnings have now topped expectations in five of the last six quarters.
- On a year-to-date basis, Coach has outperformed the S&P 500, rising 14% to the S&P's 3.5%. The shares have declined on four of the last six reporting dates.
- We believe that expectations are somewhat elevated ahead of the April 28 release.
  - An analysis of the options market on Bloomberg suggests an earnings-day move of 7.7%, compared to an average move of 6% on earnings day.
  - The one-day move has been greater than 6% in eight of the last 10 quarters, with moves of less than 7% following the last three releases.
- A factor that could dampen volatility is Coach's 3.2% dividend yield, which ranks in the top quintile of the S&P 500.
  - We think the dividend looks compelling for income-oriented investors given management's commitment to maintaining the payout during the current business transformation and to raising it once the turnaround takes hold.

Quick Recap of 2Q Earnings

- Adjusted earnings of $0.72 per share came in above our forecast of $0.65 and the Bloomberg consensus of $0.66.
  - Adjusted earnings were down 32% from the prior-year quarter.
  - Shares up 6.8%
- What did investors like in the quarter?
  - Small, but favorable, indicators that the turnaround is gaining traction.
    - The 20 stores that are offering the expanded product line and the new store environment seem to be resonating with customers.
      - They are performing substantially better than the rest of the business.

    - Another positive is that some of the company's key customers have better perceptions of product quality and higher affinity for the brand.
    - Investors seemed to like is that “in-store” comparable sales, excluding the reduction in online sale events, declined by 16% in 2Q compared to a 19% decline in 1Q.
        - The 2Q result is still a big drop, but there was sequential improvement. Management expects the 'store comp' trend to improve as new product penetration grows and more stores are redesigned.
    - We also believe that investors were pleased by the gross margin.
        - There may have been a perception that gross margin would be really dreadful because of a very promotional holiday season for the retail sector.
        - The actual result was down only slightly year-over-year and was a little better than consensus.

Our Recommendation

- We are maintaining our HOLD rating.
    - Solid financial strength.
    - 3.2% dividend yield.
    - Leading presence in a growing industry.
- Our published bias is for raising our recommendation.
- We have a roadmap for what it would take for us to become more positive on the shares.
    - We ultimately want to see is evidence that the company's products are resonating with customers.
        - We want to see that traffic is improving because more people want to see what is new at Coach stores or get a glimpse of what their friends are buzzing about.
        - In addition, we want to see conversion improving because people who are visiting stores are seeing something they want to buy.
            - At full price rather -- than because of a deep discount.
        - We also want to see the average ticket increasing:
            - Because of less discounting.
            - Because people are willing to pay up for more unique bags.
            - Because shoppers are buying multiple items when they visit.
    - Beyond market share, we are currently watching conversion and average ticket in company-owned stores for signs of improvement.
        - There will be swings in these operating metrics that we will have to analyze.
        - Evidence of overall improvement could take several quarters.
        - Our current read is that average ticket is increasing as the company emphasizes leather bags over cheaper logo bags, which seem to have lost popularity.
        - Customers seem to be gravitating to bags priced over $400, which are becoming a larger portion of the product mix.
            - This may also be a byproduct of Coach losing lower-priced business to brands like Michael Kors.
        - We expect some near-term swings in ticket because:
            - Coach is likely to improve the offering of lower-priced merchandise to regain business.

        - Conversion was lower in 2Q.
            - We believe that lower promotional activity is currently the major driver of lower conversion.
            - When Coach has reduced and lapped the current level of promotional activity, we expect conversion to improve as loyal shoppers pull the trigger more often on purses and an expanding array of shoes and accessories.
    - Traffic will be a longer-term challenge based on weak trends at malls, but more people should return to the stores as management restores the brand's reputation

Remember

- The company's 20% decrease in North American sales during the important holiday quarter suggests that COH is still surrendering share in a luxury handbag market that is growing at a very healthy high single-digit rate.
- We don't view Coach as an asset play.
- The value proposition is that COH sells handbags at high margins.
- We need to see sales gain traction against mid-priced competitors such as Michael Kors, Kate Spade, Marc Jacobs and Tory Burch.

Cardinal Health Inc. (NYSE: CAH: BUY)
Target Price: $105
David Toung
4/27/2015

Cardinal reports Thursday before open

- Here is what to look for in the quarter.
    - Uptake in volume for hepatitis C drugs drives revenue and EPS growth.
    - Update on Cardinal's plans for integrating acquisitions (Cordis and specialty distributor).
    - Update on expansion in China.
    - Benefits to margin from generic price inflation.
- CAH has surprised on the upside in each of the past 8 quarter.
- Consensus for quarter is $1.10.
- CAH +13.1% YTD, outperforming MCK but underperforming ABC.
- We think market underappreciates CAH vs. its rivals. One reason – Cardinal is the smallest in specialty distribution. Most recent acquisition may enable Cardinal to gain share in specialty.