POLO RALPH LAUREN CORP
Form 10-Q
August 07, 2008

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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 June 28, 2008

or

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

Commission file number: 001-13057

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

Delaware	**13-2622036**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
650 Madison Avenue, New York, New York	**10022**
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code:
(212) 318-7000

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 o

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 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 o Non-accelerated filer

Smaller reporting company o

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

At August 1, 2008, 56,459,719 shares of the registrant s Class A common stock, $.01 par value, and 43,280,021 shares of the registrant s Class B common stock, $.01 par value, were outstanding.

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CONSOLIDATED BALANCE SHEETS

	June 28, 2008	March 29, 2008
	(millions) (unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 553.8	$ 551.5
Short-term investments	157.0	74.3
Accounts receivable, net of allowances of $163.7 and $172.0 million	310.1	508.4
Inventories	568.1	514.9
Deferred tax assets	77.3	76.6
Prepaid expenses and other	132.5	167.8
Total current assets	1,798.8	1,893.5
Property and equipment, net	706.3	709.9
Deferred tax assets	120.4	116.9
Goodwill	977.2	975.1
Intangible assets, net	345.6	349.3
Other assets	313.3	320.8
Total assets	$ 4,261.6	$ 4,365.5
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 224.9	$ 205.7
Income tax payable	29.5	28.8
Accrued expenses and other	459.8	467.7
Current maturities of debt		206.4
Total current liabilities	714.2	908.6
Long-term debt	469.8	472.8
Non-current liability for unrecognized tax benefits	157.2	155.2
Other non-current liabilities	436.0	439.2
Commitments and contingencies (Note 12)		
Total liabilities	1,777.2	1,975.8
Stockholders equity:		
Class A common stock, par value $.01 per share; 71.5 million and 70.5 million shares issued; 56.8 million and 56.2 million shares outstanding	0.7	0.7
Class B common stock, par value $.01 per share; 43.3 million shares issued and outstanding	0.4	0.4

Additional paid-in-capital	1,037.8	1,017.6
Retained earnings	2,169.5	2,079.3
Treasury stock, Class A, at cost (14.7 million and 14.3 million shares)	(847.9)	(820.9)
Accumulated other comprehensive income (loss)	123.9	112.6
Total stockholders equity	2,484.4	2,389.7
Total liabilities and stockholders equity	$ 4,261.6	$ 4,365.5

See accompanying notes.

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POLO RALPH LAUREN CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended	
	June 28, 2008	**June 30, 2007**
	(millions, except per share data) (unaudited)	
Net sales	$ 1,066.9	$ 1,024.0
Licensing revenue	46.7	46.3
Net revenues	1,113.6	1,070.3
Cost of goods sold[a]	(475.2)	(478.3)
Gross profit	638.4	592.0
Other costs and expenses:		
Selling, general and administrative expenses[a]	(486.9)	(438.5)
Amortization of intangible assets	(4.9)	(7.7)
Total other costs and expenses	(491.8)	(446.2)
Operating income	146.6	145.8
Foreign currency gains (losses)	0.1	(1.3)
Interest expense	(7.0)	(5.8)
Interest and other income, net	7.2	8.2
Equity in income (loss) of equity-method investees	(0.7)	
Minority interest expense		(1.8)
Income before provision for income taxes	146.2	145.1
Provision for income taxes	(51.0)	(56.8)
Net income	$ 95.2	$ 88.3
Net income per common share:		
Basic	$ 0.96	$ 0.85
Diluted	$ 0.93	$ 0.82

Weighted average common shares outstanding:				
Basic		99.5		103.9
Diluted		102.1		107.3
Dividends declared per share	$	0.05	$	0.05
[(a)] Includes total depreciation expense of:	$	(41.2)	$	(35.4)

See accompanying notes.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	June 28, 2008	June 30, 2007
	(millions) (unaudited)	
Cash flows from operating activities:		
Net income	$ 95.2	$ 88.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	46.1	43.1
Deferred income tax expense (benefit)	(4.0)	(4.1)
Minority interest expense		1.8
Equity in (income) loss of equity-method investees, net of dividends received	0.7	
Non-cash stock compensation expense	10.3	10.2
Non-cash provision for bad debt expense	0.4	0.2
Non-cash foreign currency losses (gains)	(1.4)	(1.2)
Changes in operating assets and liabilities:		
Accounts receivable	197.2	170.9
Inventories	(53.6)	(25.1)
Accounts payable and accrued liabilities	75.8	23.9
Deferred income liabilities	(1.0)	(4.0)
Other balance sheet changes	31.0	(23.2)
Net cash provided by operating activities	396.7	280.8
Cash flows from investing activities:		
Acquisitions and ventures, net of cash acquired and purchase price settlements	(10.6)	(179.5)
Purchases of investments	(83.0)	
Proceeds from sales and maturities of investments	10.0	
Capital expenditures	(56.1)	(44.7)
Cash deposits restricted in connection with taxes	(5.4)	(0.7)
Net cash used in investing activities	(145.1)	(224.9)
Cash flows from financing activities:		
Proceeds from issuance of debt		168.9
Repayment of debt	(196.8)	
Debt issuance costs		(0.2)
Payments of capital lease obligations	(1.3)	(1.3)
Payments of dividends	(5.0)	(5.2)
Repurchases of common stock, including shares surrendered for tax withholdings	(51.0)	(187.8)
Proceeds from exercise of stock options	7.1	24.2

Excess tax benefits from stock-based compensation arrangements	2.8	26.1
Net cash (used in) provided by financing activities	(244.2)	24.7
Effect of exchange rate changes on cash and cash equivalents	(5.1)	(1.3)
Net increase in cash and cash equivalents	2.3	79.3
Cash and cash equivalents at beginning of period	551.5	563.9
Cash and cash equivalents at end of period	$ 553.8	$ 643.2

See accompanying notes.

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POLO RALPH LAUREN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In millions, except per share data and where otherwise indicated)
(Unaudited)

1. Description of Business

Polo Ralph Lauren Corporation (PRLC) 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. PRLC s long-standing reputation and distinctive image have been consistently developed across an expanding number of products, brands and international markets. PRLC s brand names include *Polo by Ralph Lauren, Ralph Lauren Purple Label, Ralph Lauren Collection, Black Label, Blue Label, Lauren by Ralph Lauren, RRL, RLX, Rugby, Ralph Lauren Childrenswear, Chaps, Club Monaco* and *American Living*, among others. PRLC 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 and specialty stores located throughout the U.S., Europe and Asia. The Company also sells directly to consumers through full-price and factory retail stores located throughout the U.S., Canada, Europe, South America and Asia, and through its retail internet site located at www.RalphLauren.com. In addition, the Company often licenses the right to unrelated third parties 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 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 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 29, 2008 is derived from the audited financial statements included in the Company s Annual Report on Form 10-K filed with the SEC for the fiscal year ended March 29, 2008 (the Fiscal 2008 10-K), which should be read in conjunction with these interim financial statements. Reference is made to the Fiscal 2008 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 and cash flows of the Company and all entities in which the Company has a controlling voting interest. The unaudited interim consolidated financial statements also include the accounts of any variable interest entities in which the Company is considered to be the primary beneficiary and such entities are required to be consolidated in accordance with accounting principles generally accepted in the U.S. (US GAAP).

All significant intercompany balances and transactions have been eliminated in consolidation.

Fiscal Year

The Company utilizes a 52-53 week fiscal year ending on the Saturday closest to March 31. As such, fiscal year 2009 will end on March 28, 2009 and will be a 52-week period (Fiscal 2009). Fiscal year 2008 ended on March 29,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2008 and reflected a 52-week period (Fiscal 2008). In turn, the first quarter for Fiscal 2009 ended on June 28, 2008 and was a 13-week period. The first quarter for Fiscal 2008 ended on June 30, 2007 and was also a 13-week period.

The financial position and operating results of the Company s consolidated Polo Ralph Lauren Japan Corporation (PRL Japan) and Impact 21 Co., Ltd. (Impact 21) entities located in Japan are reported on a one-month lag. Accordingly, the Company s operating results for the three-month periods ended June 28, 2008 and June 30, 2007 include the operating results of PRL Japan and Impact 21 for the three-month periods ended May 31, 2008 and May 31, 2007, respectively. The net effect of this reporting lag is not material to the unaudited interim consolidated financial statements.

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 unaudited interim consolidated financial statements include reserves for 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; and accounting for business combinations.

Seasonality of Business

The Company s business is 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 periods in the Retail segment. Accordingly, the Company s operating results and cash flows for the three months ended June 28, 2008 are not necessarily indicative of the results and cash flows that may be expected for the full Fiscal 2009.

Reclassifications

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

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 collectibility 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 markdowns,

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, seasonal results, an evaluation of current economic and market conditions and retailer performance. Estimates for operational chargebacks are based on actual notifications of order fulfillment discrepancies and historical trends. The Company reviews and refines these estimates on a quarterly basis. The Company s historical estimates of these costs have not differed materially from actual results.

Retail store 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 site known as RalphLauren.com is

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recognized upon delivery and receipt of the shipment by its customers. Such revenue also is 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.

Net Income Per Common Share

Net income per common share is determined in accordance with Statement of Financial Accounting Standards (FAS) No. 128, Earnings per Share (FAS 128). Under the provisions of FAS 128, 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.

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	
	June 28, 2008	June 30, 2007
	(millions)	
Basic	99.5	103.9
Dilutive effect of stock options, restricted stock and restricted stock units	2.6	3.4
Diluted shares	102.1	107.3

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 performance-based restricted stock units that are

issuable only upon the achievement of certain performance goals. Such units only are included in the computation of diluted shares to the extent the underlying performance conditions (a) are satisfied prior to 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. As of June 28, 2008 and June 30, 2007, there was approximately 1.3 million and 1.1 million, respectively, of additional shares issuable upon the exercise of anti-dilutive options and/or 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 customers that satisfy defined credit criteria. Accounts receivable, net, as shown in the Company s consolidated balance sheets, is net of certain reserves and allowances. These reserves and allowances consist of (a) reserves for returns, discounts, end-of-season markdowns

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and operational chargebacks and (b) allowances for doubtful accounts. These reserves and allowances are discussed in further detail below.

A reserve for sales returns is determined based on an evaluation of current market conditions and historical returns experience. Charges to increase the reserve are treated as reductions of revenue.

A reserve for trade discounts is determined based on open invoices where trade discounts have been extended to customers, and charges to increase the reserve are treated as reductions of revenue.

Estimated end-of-season markdown charges are included as reductions of revenue. The related markdown provisions are based on retail sales performance, seasonal negotiations with customers, historical deduction trends and an evaluation of current market conditions.

A reserve for operational chargebacks represents various deductions by customers relating to individual shipments. Charges to increase this reserve, net of expected recoveries, are included as reductions of revenue. The reserve is based on actual notifications of order fulfillment discrepancies and past experience.

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	
	June 28, 2008	June 30, 2007
	(millions)	
Beginning reserve balance	$ 161.1	$ 129.4
Amount charged against revenue to increase reserve	96.0	94.3
Amount credited against customer accounts to decrease reserve	(103.9)	(96.2)
Foreign currency translation	(0.4)	0.4
Ending reserve balance	$ 152.8	$ 127.9

An allowance for doubtful accounts is determined through analysis of periodic aging of accounts receivable, assessments of collectibility based on an evaluation of historic and anticipated trends, the financial condition of the Company s customers, and an evaluation of the impact of economic conditions. A rollforward of the activity in the Company s allowance for doubtful accounts is presented below:

	Three Months Ended	
	June 28, 2008	June 30, 2007

	(millions)	
Beginning reserve balance	$ 10.9	$ 8.7
Amount charged to expense to increase reserve	0.4	0.2
Amount written off against customer accounts to decrease reserve	(0.3)	(0.4)
Foreign currency translation	(0.1)	0.1
Ending reserve balance	$ 10.9	$ 8.6

4. Recently Issued Accounting Standards

Fair Value Measurement

In September 2006, the Financial Accounting Standards Board (FASB) issued FAS No. 157, Fair Value Measurements (FAS 157 or the Standard). FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date within an identified principal or most advantageous market, establishes a framework for measuring fair value in

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

accordance with US GAAP and expands disclosures regarding fair value measurements. The Company adopted the provisions of FAS 157 for all of its financial assets and liabilities within the Standard s scope as of the beginning of Fiscal 2009 (March 30, 2008). FAS 157 will become effective for all nonfinancial assets and liabilities of the Company within the scope of FAS 157 as of the beginning of Fiscal 2010 (March 29, 2009). The adoption of the provisions of FAS 157 effective during Fiscal 2009 did not have a significant impact on the Company s consolidated financial statements. The Company is in the process of evaluating the impact of the provisions of FAS 157 to be adopted in Fiscal 2010. Refer to Note 9 for further discussion on the impact of adoption on the Company s consolidated financial statements.

Other Recently Issued Accounting Standards

In March 2008, the FASB issued FAS No. 161, Disclosures about Derivative Instruments and Hedging Activities (FAS 161). FAS 161 amends FAS 133 to provide enhanced disclosure requirements surrounding how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under FAS 133 and how derivative instruments and related hedged items affect an entity s financial position, financial performance and cash flows. FAS 161 is effective for the Company as of the beginning of Fiscal 2010, including interim periods thereafter. The implementation of FAS 161 is not expected to have a material impact on the Company s consolidated financial statements.

In December 2007, the FASB issued FAS No. 141R, Business Combinations (FAS 141R), which replaces FAS No. 141. FAS 141R was issued to create greater consistency in the accounting and financial reporting of business combinations, resulting in more complete, comparable and relevant information for investors and other users of financial statements. FAS 141R establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any noncontrolling interests in the acquiree, as well as the goodwill acquired. Significant changes from current practice resulting from FAS 141R include the need for the acquirer to record 100% of all assets and liabilities of the acquired business, including goodwill, generally at their fair values for all business combinations (whether partial, full or step acquisitions); the need to recognize contingent consideration at its fair value on the acquisition date and, for certain arrangements, to recognize changes in fair value in earnings until settlement; and the need to expense acquisition-related transaction and restructuring costs rather than to treat them as part of the cost of the acquisition. FAS 141R also establishes disclosure requirements to enable users to evaluate the nature and financial effects of the business combination. FAS 141R is effective for the Company as of the beginning of Fiscal 2010 and will be applied prospectively to business combinations that close on or after March 29, 2009.

In December 2007, the FASB issued FAS No. 160, Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51 (FAS 160). FAS 160 establishes accounting and reporting standards for noncontrolling interests (previously referred to as minority interests) in a subsidiary and for the deconsolidation of a subsidiary, to ensure consistency with the requirements of FAS 141R. FAS 160 states that noncontrolling interests should be classified as a separate component of equity, and establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. FAS 160 is effective for the Company as of the beginning of Fiscal 2010 and the application of FAS 160 is not expected to have a material effect on the Company s consolidated financial statements.

In February 2007, the FASB issued FAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FAS No. 115 (FAS 159 or the Standard). FAS 159 permits companies to choose to measure, on an instrument-by-instrument basis, financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses on items for which the fair value option is elected will be recognized in earnings at each subsequent reporting date. The Company did not elect the fair value option for any of its financial assets or financial liabilities upon adoption of the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Standard in the beginning of Fiscal 2009. Therefore, the initial application of FAS 159 did not have a material effect on the Company s consolidated financial statements.

5. Acquisitions and Joint Ventures

Fiscal 2009 Transactions

Japanese Childrenswear and Golf Acquisition

On August 1, 2008, in connection with the transition of the Polo-branded childrenswear and golf apparel businesses in Japan from a licensed to a wholly owned operation, the Company acquired certain net assets (including certain inventory) from Naigai Co. Ltd. (Naigai) in exchange for a payment of approximately ¥2.5 billion (approximately $23 million as of the acquisition date) and certain other consideration (the Japanese Childrenswear and Golf Acquisition). Naigai was the Company s licensee for childrenswear, golf attire and hosiery under the *Polo by Ralph Lauren* and *Ralph Lauren* brands in Japan. In conjunction with the Japanese Childrenswear and Golf Acquisition, the Company also entered into an additional 5 year licensing and design-related agreement with Naigai for Polo and Chaps-branded hosiery in Japan and a transition services agreement for the provision of a variety of operational, human resources and information systems-related services over a period of up to eighteen months from the date of the closing of the transaction.

The Company expects to account for the Japanese Childrenswear and Golf Acquisition as an asset purchase during the second quarter of Fiscal 2009 and is in the process of preparing its assessment of the fair value of the assets acquired and liabilities assumed. Based on preliminary valuation analyses prepared by an independent valuation firm, the Company expects to allocate all of the consideration exchanged in the Japanese Childrenswear and Golf Acquisition to the net assets acquired in connection with the transaction. Accordingly, no settlement loss associated with any pre-existing relationships is expected to be recognized.

Fiscal 2008 Transactions

Japanese Business Acquisitions

On May 29, 2007, the Company completed the transactions to acquire control of certain of its Japanese businesses that were formerly conducted under licensed arrangements, consistent with the Company s long-term strategy of international expansion. In particular, the Company acquired approximately 77% of the outstanding shares of Impact 21 that it did not previously own in a cash tender offer (the Impact 21 Acquisition), thereby increasing its ownership in Impact 21 from approximately 20% to approximately 97%. Impact 21 conducts the Company s men s, women s and jeans apparel and accessories business in Japan under a pre-existing, sub-license arrangement. In addition, the Company acquired the remaining 50% interest in PRL Japan, which holds the master license to conduct Polo s business in Japan, from Onward Kashiyama Co. Ltd and its affiliates (Onward Kashiyama) and The Seibu Department Stores, Ltd (Seibu) (the PRL Japan Minority Interest Acquisition). Collectively, the Impact 21 Acquisition and the PRL Japan Minority Interest Acquisition are herein referred to as the Japanese Business Acquisitions.

The purchase price initially paid in connection with the Japanese Business Acquisitions was approximately $360 million, including transaction costs of approximately $12 million. In January 2008, at an Impact 21 shareholders

meeting, the Company obtained the necessary approvals to complete the process of acquiring the remaining approximately 3% of outstanding shares not exchanged as of the close of the tender offer period (the minority squeeze-out). In February 2008, the Company acquired approximately 1% of the remaining Impact 21 shares outstanding at an aggregate cost of $5 million. During the first quarter of Fiscal 2009, the Company completed the minority squeeze-out at an aggregate cost of approximately $9 million.

The Company funded the Japanese Business Acquisitions with available cash on-hand and ¥20.5 billion of borrowings under a one-year term loan agreement pursuant to an amendment and restatement to the Company s

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

existing credit facility. The Company repaid the borrowing by its maturity date on May 22, 2008 using $196.8 million of Impact 21 s cash on-hand acquired as part of the acquisition.

Based on valuation analyses prepared by an independent valuation firm, the Company allocated all of the consideration exchanged to the purchase of the Japanese businesses. The acquisition cost of approximately $374 million has been allocated to the net assets acquired based on their respective fair values as follows: cash of $189 million; trade receivables of $26 million; inventory of $38 million; finite-lived intangible assets of $75 million (consisting of the re-acquired licenses of $21 million and customer relationships of $54 million); non-tax-deductible goodwill of $140 million; assumed pension liabilities of $5 million; net deferred tax liabilities of $31 million; and other net liabilities of $58 million.

The results of operations for Impact 21, which were previously accounted for using the equity method of accounting, have been consolidated in the Company s results of operations commencing April 1, 2007. Accordingly, the Company recorded within minority interest expense the amount of Impact 21 s net income allocable to the holders of the approximate 80% of the Impact 21 shares not owned by the Company prior to the closing date of the tender offer. The results of operations for PRL Japan had already been consolidated by the Company in all prior periods.

6. Inventories

Inventories consist of the following:

	June 28, 2008	March 29, 2008	June 30, 2007
		(millions)	
Raw materials	$ 9.3	$ 6.7	$ 6.8
Work-in-process	1.8	1.7	1.9
Finished goods	557.0	506.5	596.0
Total inventory	$ 568.1	$ 514.9	$ 604.7

7. 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 months ended June 28, 2008 is presented below:

	Three Months Ended June 28,

		2008 (millions)
Unrecognized tax benefits beginning balance	$	117.5
Additions (reductions) related to current period tax positions		1.9
Additions (reductions) related to prior periods tax positions		(0.2)
Unrecognized tax benefits ending balance	$	119.2

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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 months ended June 28, 2008 is presented below:

	Three Months Ended June 28, 2008 (millions)
Accrued interest and penalties beginning balance	$ 48.0
Additions (reductions) charged to expense	2.3
Accrued interest and penalties ending balance	$ 50.3

The total amount of unrecognized tax benefits, including interest and penalties, was $169.5 million as of June 28, 2008, and was comprised of $12.3 million included within accrued expenses and other and $157.2 million included within non-current liability for unrecognized tax benefits in the consolidated balance sheet. The total amount of unrecognized tax benefits that, if recognized, would affect the Company s effective tax rate was $126.2 million as of June 28, 2008.

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 audits and/or 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 $40 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 2000.

8. Debt

Euro Debt

The Company has outstanding approximately 300 million principal amount of 4.5% notes due October 4, 2013 (the 2006 Euro Debt). The Company has the option to redeem all of the 2006 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 2006 Euro Debt at any time at par plus accrued interest in the event of certain developments involving U.S. tax law. Partial redemption

of the 2006 Euro Debt is not permitted in either instance. In the event of a change of control of the Company, each holder of the 2006 Euro Debt has the option to require the Company to redeem the 2006 Euro Debt at its principal amount plus accrued interest.

As of June 28, 2008, the carrying value of the 2006 Euro Debt was $469.8 million, compared to $472.8 million as of March 29, 2008.

Revolving Credit Facility and Term Loan

The Company has a credit facility that provides for a $450 million unsecured revolving line of credit through November 2011 (the Credit Facility). The Credit Facility also is used to support the issuance of letters of credit. As of June 28, 2008, there were no borrowings outstanding under the Credit Facility, but the Company was

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contingently liable for $23.5 million of outstanding letters of credit (primarily relating to inventory purchase commitments). The Company has the ability to expand its borrowing availability to $600 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 Credit Facility.

The 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 and contingent liabilities; sell or dispose of assets, including equity interests; 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 investments. In addition, the Credit Facility requires the Company to maintain a maximum ratio of Adjusted Debt to Consolidated EBITDAR (the leverage ratio), as such terms are defined in the Credit Facility. As of June 28, 2008, no Event of Default (as such term is defined pursuant to the Credit Facility) has occurred under the Company s Credit Facility.

The Credit Facility was amended and restated as of May 22, 2007 to provide for the addition of a ¥20.5 billion loan (the Term Loan). The Term Loan was made to Polo JP Acqui B.V., a wholly owned subsidiary of the Company, and was guaranteed by the Company, as well as the other subsidiaries of the Company which currently guarantee the Credit Facility. The proceeds of the Term Loan were used to finance the Japanese Business Acquisitions. Borrowings under the Term Loan bore interest at a fixed rate of 1.2%. The Company repaid the borrowing by its maturity date on May 22, 2008 using $196.8 million of Impact 21 s cash on-hand acquired as part of the acquisition. See Note 5 for further discussion of the Japanese Business Acquisitions.

Refer to Note 13 of the Fiscal 2008 10-K for detailed disclosure of the terms and conditions of the Company s debt.

9. Financial Instruments

Fair Value Measurement

FAS 157 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The determination of the applicable level within the hierarchy of a particular asset or liability depends on the inputs used in valuation as of the measurement date, notably the extent to which the inputs are market-based (observable) or internally derived (unobservable). 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 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.

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.

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

	June 28, 2008[a] (millions)	
Financial assets carried at fair value:		
Derivative financial instruments	$	5.0
Auction rate securities		4.8
Total	$	9.8
Financial liabilities carried at fair value:		
Derivative financial instruments	$	21.7
Total	$	21.7

[a] Based on level 2 measurements.

Derivative financial instruments designated as cash flow hedges are recorded at fair value in the Company s consolidated balance sheets and, to the extent these instruments are highly effective at reducing the risk associated with the exposure being hedged, the related unrealized gains or losses are deferred in stockholders equity as a component of accumulated other comprehensive income. The Company s derivative financial instruments are valued using a pricing model, primarily based on market observable external inputs including forward and spot rates for foreign currencies, which considers the impact of the Company s own credit risk, if any. The Company s derivative financial instruments have been classified as Level 2 assets or liabilities as of June 28, 2008.

The Company s auction rate securities are classified as available-for-sale securities and are recorded at fair value in the Company s consolidated balance sheets, with unrealized gains and losses deferred in stockholders equity as a component of accumulated other comprehensive income. As a result of current market conditions, third-party pricing institutions may value auction rate securities at par, which may not necessarily reflect prices that would be obtained 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 recently successful traded securities, and the total principal balance of each security. Auction rate securities have been classified as Level 2 assets as of June 28, 2008.

Cash and cash equivalents, short-term investments and accounts receivable are recorded at carrying value, which approximates fair value. Restricted cash is reported at carrying value. The Company s 2006 Euro Debt, which is adjusted for foreign currency fluctuations, is also reported at carrying value.

Derivative Financial Instruments

The Company primarily has exposure to changes in foreign currency exchange rates relating to certain anticipated cash flows from its international operations and possible declines in the fair value of reported net assets of certain of its foreign operations, as well as changes in the fair value of its fixed-rate debt relating to changes in interest rates. Consequently, the Company periodically uses derivative financial instruments to manage such risks. The Company does not enter into derivative transactions for speculative or trading purposes. All undesignated hedges of the Company are entered into to hedge specific economic risks.

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The following table summarizes the Company s outstanding derivative instruments as of June 28, 2008:

Instrument[a]	Hedge Type[b]	Hedged Item	Notional Amount	Fair Value	Balance Sheet Location[c]	Asset Carrying Value	Balance Sheet Location[c]	(Liability) Carrying Value
			(millions)					
Forward Sale Contracts	CF	USD inventory purchases by euro-functional sub	$ 251.0	$ (20.5)		$	AE	$ (20.5)
Forward Sale Contracts	CF	Euro royalty payments	55.7	(0.9)			AE	(0.9)
Forward Sale Contracts	CF	Yen royalty payments	33.1	0.5	PP	0.6	AE	(0.1)
Forward Sale Contracts	UN	USD inventory purchases by yen-functional sub	13.3	0.2	PP	0.2		
Forward Sale Contracts	UN	Yen loan receivable	4.8	0.3	PP	0.3		
Forward Sale Contracts	UN	GBP-denominated revenues	35.6	1.0	PP	1.0		
Forward Purchase Contracts	CF	Euro interest payment	19.2	1.9	PP	1.9		
Forward Purchase Contracts	CF	Euro marketing contributions	10.2	0.2	PP	0.2		
Forward Purchase Contracts	CF	Euro inventory purchases	42.7	0.8	PP	0.8		
Forward Purchase Contracts	CF	Swiss franc obligations	22.2	(0.2)			AE	(0.2)
Euro Debt	NI	Euro net investment	381.2	(413.8)			LTD	(469.8)
			$ 869.0	$ (430.5)		$ 5.0		$ (491.5)

(a) Forward Sale Contracts = Forward exchange contracts for sale of foreign currencies; Forward Purchase Contracts = Forward exchange contracts for purchase of foreign currencies; Euro Debt = 300 million principal notes due October 2013.

(b) CF = Cash flow hedge; UN = Undesignated hedge; NI = Net investment hedge.

(c) PP = Prepaid expenses and other; AE = Accrued expenses and other; LTD = Long-term debt.

The following is a summary of the Company s risk management strategies and the effect of those strategies on the Company s consolidated financial statements.

Foreign Currency Risk Management

Forward Foreign Currency Exchange Contracts General

The Company 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 made to fund certain marketing efforts of its international operations, other foreign currency-denominated operational obligations including payroll, rent, insurance, and benefit payments, and foreign currency-denominated revenues. As part of its overall strategy to manage the level of exposure to the risk of foreign currency exchange rate fluctuations, primarily to changes in the value of the Euro, the Japanese Yen, the Swiss Franc, and the British Pound Sterling, the Company hedges a portion of its foreign currency exposures anticipated over the ensuing twelve-month to two-year periods. In doing so, the Company uses foreign currency exchange contracts that generally have maturities of three months to two years to provide continuing coverage throughout the hedging period.

The Company records the above described foreign currency exchange contracts at fair value in its consolidated balance sheets. Foreign currency exchange contracts designated as cash flow hedges at hedge inception are accounted for in accordance with FAS 133. As such, to the extent these hedges are effective the related gains or losses are deferred in stockholders equity as a component of accumulated other comprehensive income. These deferred gains and losses are then recognized in our consolidated statements of operations in the period in which the underlying transaction affects earnings. To the extent that any of these foreign currency exchange contracts are not

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considered to be perfectly effective in offsetting the change in the value of the hedged item, any changes in fair value relating to the ineffective portion are immediately recognized in earnings.

The Company reclassified from accumulated other comprehensive income into earnings a net loss on foreign currency exchange contracts of approximately $0.9 million during the three months ended June 28, 2008 and a net gain of $0.6 million during the three months ended June 30, 2007, representing the effective portion of losses and gains on derivative instruments qualifying as cash flow hedges. No material gains or losses relating to ineffective hedges were recognized in the periods presented.

Forward Foreign Currency Exchange Contracts Other

During the first quarter of Fiscal 2009, the Company entered into a foreign currency exchange contract with a notional value of $4.8 million hedging the foreign currency exposure related to an intercompany term loan provided by Polo Fin B.V. to Polo JP Acqui B.V. in connection with the Japanese Business Acquisitions minority squeeze-out, as discussed in Note 5. This contract, which hedged the foreign currency exposure related to a Yen-denominated payment during the first quarter of Fiscal 2009, did not qualify under FAS 133 for hedge accounting treatment. No related material gains or losses were recognized during the three months ended June 28, 2008.

During the first quarter of Fiscal 2008, the Company entered into foreign currency option contracts with a notional value of $159 million giving the Company the right, but not the obligation, to purchase foreign currencies at fixed rates by May 23, 2007. These contracts hedged the majority of the foreign currency exposure related to the financing of the Japanese Business Acquisitions, but did not qualify under FAS 133 for hedge accounting treatment. The Company did not exercise the contracts and, as a result, recognized a loss of $1.6 million during the three months ended June 30, 2007.

10. Stockholders Equity

Summary of Changes in Stockholders Equity

	Three Months Ended	
	June 28, 2008	**June 30, 2007**
	(millions)	
Balance at beginning of period	$ 2,389.7	$ 2,334.9
Cumulative effect of adopting FIN 48		(62.5)
Comprehensive income:		
Net income	95.2	88.3
Foreign currency translation adjustments	6.9	2.4
Net realized and unrealized gains (losses) on derivative financial instruments	4.2	(2.6)
Net unrealized gains on available-for-sale investments	0.2	
Total comprehensive income	106.5	88.1

Cash dividends declared	(5.0)	(5.2)
Repurchases of common stock	(27.0)	(187.8)
Shares issued and equity grants made pursuant to stock compensation plans		