

TIFFANY & CO
Form 10-K
March 28, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended January 31, 2012

OR

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

For the transition period from to

Commission file no. 1-9494

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

13-3228013
(I.R.S. Employer
Identification No.)

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727 Fifth Avenue, New York,

New York
(Address of principal executive offices)

10022
(Zip code)

Registrant's telephone number, including area code: (212)755-8000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form10-K or any amendment to this Form10-K.

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 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 Act). Yes No

As of July 29, 2011, the aggregate market value of the registrant's voting and non-voting stock held by non-affiliates of the registrant was approximately \$9,713,269,057 using the closing sales price on this day of \$79.59. See Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

As of March 20, 2012, the registrant had outstanding 126,379,085 shares of its common stock, \$.01 par value per share.

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DOCUMENTS INCORPORATED BY REFERENCE.

The following documents are incorporated by reference into this Annual Report on Form 10-K: Registrant's Proxy Statement Dated April 5, 2012 (Part III).

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including documents incorporated herein by reference, contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 concerning the Registrant's goals, plans and projections with respect to store openings, sales, retail prices, gross margin, expenses, effective tax rate, net earnings and net earnings per share, inventories, capital expenditures, cash flow and liquidity. In addition, management makes other forward-looking statements from time to time concerning objectives and expectations. One can identify these forward-looking statements by the fact that they use words such as believes, intends, plans and expects and other words and terms of similar meaning and expression in connection with any discussion of future operating or financial performance. One can also identify forward-looking statements by the fact that they do not relate strictly to historical or current facts. Such forward-looking statements are based on management's current plans and involve inherent risks, uncertainties and assumptions that could cause actual outcomes to differ materially from current plans. The Registrant has included important factors in the cautionary statements included in this Annual Report, particularly under Item 1A. Risk Factors, that the Registrant believes could cause actual results to differ materially from any forward-looking statement.

Although the Registrant believes it has been prudent in its plans and assumptions, no assurance can be given that any goal or plan set forth in forward-looking statements can or will be achieved, and readers are cautioned not to place undue reliance on such statements which speak only as of the date this Annual Report on Form 10-K was first filed with the Securities and Exchange Commission. The Registrant undertakes no obligation to update any of the forward-looking information included in this document, whether as a result of new information, future events, changes in expectations or otherwise.

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PART I

Item 1. Business.

GENERAL HISTORY OF BUSINESS

The Registrant (also referred to as Tiffany & Co. or the Company) is the parent corporation of Tiffany and Company (Tiffany). Charles Lewis Tiffany founded Tiffany's business in 1837. He incorporated Tiffany in New York in 1868. The Registrant acquired Tiffany in 1984 and completed the initial public offering of the Registrant's Common Stock in 1987. The Registrant is a holding company and conducts all business through its subsidiary corporations. Through those subsidiaries, the Company sells jewelry and other items that it manufactures or has made by others to its specifications.

FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS

The Registrant's segment information for the fiscal years ended January 31, 2012, 2011 and 2010 is reported in Item 8. Financial Statements and Supplementary Data Note Q. Segment Information.

NARRATIVE DESCRIPTION OF BUSINESS

All references to years relate to fiscal years that end on January 31 of the following calendar year.

MAINTENANCE OF THE TIFFANY & CO. BRAND

The TIFFANY & CO. brand (the Brand) is the single most important asset of Tiffany and, indirectly, of the Registrant. The strength of the Brand goes beyond trademark rights (see TRADEMARKS below) and is derived from consumer perceptions of the Brand. Management monitors the strength of the Brand through focus groups and survey research.

Management believes that consumers associate the Brand with high-quality gemstone jewelry, particularly diamond jewelry; excellent customer service; an elegant store and online environment; upscale store locations; classic product positioning; distinctive and high-quality packaging materials (most significantly, the TIFFANY & CO. blue box); and sophisticated style and romance. Tiffany's business plan includes expenses to maintain the strength of the Brand, such as the following:

To provide excellent service, stores must be well staffed with knowledgeable professionals;

Elegant stores in the best high street and luxury mall locations are more expensive and difficult to secure and maintain, but reinforce the Brand's luxury connotations through association with other luxury brands;

In-store display practices enable Tiffany to showcase fine jewelry in a manner consistent with the Brand's positioning but require sufficient space;

The classic positioning of much of Tiffany's product line supports the Brand, but limits the display space that can be allocated to new product introductions;

Tiffany's packaging supports consumer expectations with respect to the Brand but is expensive;

A significant amount of advertising is required to both reinforce the Brand's association with luxury, sophistication, style and romance, as well as to market specific products; and

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Maintaining its position within the high-end of the jewelry market requires Tiffany to invest significantly in diamond and gemstone inventory and to accept reduced overall gross margins; it also causes some consumers to view Tiffany as beyond their price range. All of the foregoing require that management make tradeoffs between business initiatives that might generate incremental sales and profits and Brand maintenance objectives. This is a dynamic process. To the extent that management deems that product, advertising or distribution initiatives will unduly and negatively affect the strength of the Brand, such initiatives have been and will be curtailed or modified appropriately. At the same time, Brand maintenance suppositions are regularly questioned by management to determine if the tradeoff between sales and profit is truly worth the positive effect on the Brand. At times, management has determined, and will in the future determine, that the strength of the Brand warranted, or that it will permit, more aggressive and profitable distribution and marketing initiatives.

REPORTABLE SEGMENTS

Americas

In 2011, sales in the Americas were 50% of consolidated worldwide net sales, while sales in the U.S. represented 90% of net sales in the Americas.

Retail Sales. Retail sales are transacted in Company-operated TIFFANY & CO. stores in (number of stores at January 31, 2012 included in parentheses): the U.S. (87), Mexico (7), Canada (5) and Brazil (3). Included within these totals are six Company-operated stores located within various department stores.

Internet and Catalog Sales. Tiffany and its subsidiaries distribute a selection of their products in the U.S. and Canada through the websites at www.tiffany.com and www.tiffany.ca. Tiffany also distributes catalogs of selected merchandise to its proprietary list of customers in the U.S. and Canada and to mailing lists rented from third parties. SELECTIONS® catalogs are published four times per year, supplemented by other targeted catalogs.

Business-to-Business Sales. Business sales executives call on business clients, selling products drawn from the retail product line and items specially developed for the business market, including trophies and items designed for the particular customer. Most sales occur in the U.S. Price allowances are given to business account holders for certain purchases. Business customers have typically made purchases for gift giving, employee service and achievement recognition awards, customer incentives and other purposes. Products and services are marketed through a sales organization, through advertising in newspapers, business periodicals and through the publication of special catalogs. Business account holders may make purchases through the Company's website at www.tiffany.com/business.

Wholesale Distribution. Selected TIFFANY & CO. merchandise is sold to independent distributors for resale in markets in the Central/South American, Caribbean and Canadian regions. Such sales represent less than 1% of consolidated worldwide net sales.

Asia-Pacific

In 2011, sales in Asia-Pacific represented 21% of consolidated worldwide net sales.

Retail Sales. Retail sales are transacted in Company-operated TIFFANY & CO. stores in (number of

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stores at January 31, 2012 included in parentheses): China (16), Korea (14), Hong Kong (8), Taiwan (7), Australia (5), Singapore (4), Macau (2) and Malaysia (2). Included within these totals are 21 Company-operated stores located within various department stores.

Internet Sales. The Company offers a selection of TIFFANY & CO. merchandise for purchase in Australia through its website at www.tiffany.com.au.

Wholesale Distribution. Selected TIFFANY & CO. merchandise is sold to independent distributors for resale in Asia-Pacific markets. Such sales represent less than 1% of consolidated worldwide net sales.

Japan

In 2011, sales in Japan represented 17% of consolidated worldwide net sales.

Retail Sales. The Registrant does business in Japan through its wholly-owned subsidiary, Tiffany & Co. Japan, Inc. (Tiffany-Japan), in 55 stores. Included within this total are 51 Tiffany-Japan-operated stores located within Japanese department stores, representing 79% of Tiffany-Japan's net sales. There are four large department store groups in Japan. Tiffany-Japan operates TIFFANY & CO. stores in locations controlled by these groups as follows (number of locations at January 31, 2012 included in parentheses): Isetan Mitsukoshi (15), J. Front Retailing Co. (Daimaru and Matsuzakaya department stores) (10), Takashimaya (9) and Millennium Retailing Co. (Sogo and Seibu department stores) (3). Tiffany-Japan also operates 14 stores in department stores controlled by other Japanese companies.

Internet Sales. The Company offers a selection of TIFFANY & CO. merchandise for purchase in Japan through its website at www.tiffany.co.jp.

Business-to-Business Sales. Products drawn from the retail product line and items specially developed are sold to business customers.

Wholesale Distribution. Selected TIFFANY & CO. merchandise is sold to independent distributors for resale in Japan. Such sales represent less than 1% of consolidated worldwide net sales.

Europe

In 2011, sales in Europe represented 12% of consolidated worldwide net sales, while sales in the United Kingdom represented approximately half of European net sales.

Retail Sales. Retail sales are transacted in Company-operated TIFFANY & CO. stores in (number of stores at January 31, 2012 included in parentheses): the United Kingdom (10), Germany (6), Italy (5), France (3), Spain (2), Switzerland (2), Austria (1), Belgium (1), Ireland (1) and the Netherlands (1). Included within these totals are seven Company-operated stores located within various department stores.

Internet Sales. The Company offers a selection of TIFFANY & CO. merchandise for purchase in the United Kingdom, Austria, Belgium, France, Germany, Ireland, Italy, the Netherlands and Spain through its websites which are accessible through www.tiffany.com.

Wholesale Distribution. Selected TIFFANY & CO. merchandise is sold to independent distributors for resale in Europe. Such sales represent less than 1% of consolidated worldwide net sales.

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Other

Other consists of all non-reportable segments. Other consists primarily of wholesale sales of TIFFANY & CO. merchandise to independent distributors for resale in certain emerging markets primarily in the Middle East and Russia (Emerging Markets) and wholesale sales of diamonds. In addition, Other also includes earnings received from licensing agreements with Luxottica Group for the distribution of TIFFANY & CO. brand eyewear and with The Swatch Group Ltd. (the Swatch Group) for TIFFANY & CO. brand watches. The earnings received from these licensing agreements represented less than 1% of consolidated worldwide net sales in 2011, 2010 and 2009. See Item 3. Legal Proceedings for additional information.

Wholesale Sales of Diamonds. The Company regularly purchases parcels of rough diamonds for further processing, but not all rough diamonds so purchased are suitable for Tiffany's needs. In addition, most, but not all, diamonds polished by the Company are suitable for Tiffany jewelry. The Company sells to third parties those diamonds that are found to be unsuitable for Tiffany's needs. The Company's objective from such sales is to recoup its original costs, thereby earning minimal, if any, gross margin on those transactions.

Iridesse, Inc. In the fourth quarter of 2008, management committed to a plan to close all IRIDESSE stores. All stores were closed in 2009. The results of IRIDESSE are reported as discontinued operations.

Expansion of Operations

Management regularly evaluates potential markets for new TIFFANY & CO. stores with a view to the demographics of the area to be served, consumer demand and the proximity of other luxury brands and existing TIFFANY & CO. locations. Management recognizes that oversaturation of any market could diminish the distinctive appeal of the Brand, but believes that there are a significant number of locations remaining in the Americas, Asia-Pacific (outside Japan) and Europe that meet the requirements of a TIFFANY & CO. location.

The following chart details the number of TIFFANY & CO. retail locations operated by the Registrant's subsidiary companies since 2001:

Year:	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,
	Americas	Canada & Latin America	Asia- Pacific	Japan	Europe	Total
2001	44	5	20	47	10	126
2002	47	5	20	48	11	131
2003	51	7	22	50	11	141
2004	55	7	24	53	12	151
2005	59	7	25	50	13	154
2006	64	9	28	52	14	167
2007	70	10	34	53	17	184
2008	76	10	39	57	24	206
2009	79	12	45	57	27	220
2010	84	12	52	56	29	233
2011	87	15	58	55	32	247

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As part of its long-term strategy to expand its worldwide store base, management plans to add 24 (net) Company-operated stores in 2012 (nine in the Americas, seven in Asia-Pacific, three in Europe and commence operations of five stores in Emerging Markets).

As noted above, the Company currently operates e-commerce enabled websites in 13 countries. Sales transacted on those websites accounted for 6% of consolidated worldwide net sales in 2011, 2010 and 2009. The Company continually invests in enhancing these websites and intends to expand its e-commerce sites to additional countries in the future.

Products

The Company's principal product category is jewelry, which represented 91%, 91% and 90% of the Registrant's net sales in 2011, 2010 and 2009. Tiffany offers an extensive selection of TIFFANY & CO. brand jewelry at a wide range of prices. Designs are developed by employees, suppliers, independent designers and independent named designers (see MATERIAL DESIGNER LICENSE below).

The Company also sells timepieces, sterling silver goods (other than jewelry), china, crystal, stationery, fragrances, personal accessories and leather goods, which represented, in total, 8%, 8% and 9% of the Registrant's net sales in 2011, 2010 and 2009. The Registrant's remaining 1% of net sales were attributable to wholesale sales of diamonds and earnings received from third-party licensing agreements.

Sales by Reportable Segment of TIFFANY & CO. Jewelry by Category

	September 30, % of total Americas Sales	September 30, % of total Asia-Pacific Sales	September 30, % of total Japan Sales	September 30, % of total Europe Sales	September 30, % of total Reportable Segment Sales
2011					
Statement, fine & solitaire jewelry ^a	16%	23%	12%	14%	16%
Engagement jewelry & wedding bands ^b	23%	37%	41%	24%	29%
Silver & gold jewelry ^c	33%	28%	16%	46%	30%
Designer jewelry ^d	16%	11%	23%	12%	15%
2010					
Statement, fine & solitaire jewelry ^a	15%	23%	13%	13%	16%
Engagement jewelry & wedding bands ^b	21%	35%	42%	25%	28%
Silver & gold jewelry ^c	36%	28%	17%	45%	32%
Designer jewelry ^d	17%	12%	21%	13%	16%
2009					
Statement, fine & solitaire jewelry ^a	14%	21%	11%	13%	14%
Engagement jewelry & wedding bands ^b	21%	34%	43%	23%	27%
Silver & gold jewelry ^c	38%	30%	19%	47%	34%
Designer jewelry ^d	16%	12%	20%	14%	16%

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- a) This category includes statement, fine and solitaire jewelry (other than engagement jewelry). Most jewelry in this category is constructed of platinum, although gold was used as the primary metal in approximately 5% of sales. Most items in this category contain diamonds, other gemstones or both. The average price of merchandise sold in 2011, 2010 and 2009 in this category was approximately \$5,400, \$4,400 and \$4,200 for total reportable segments.
- b) This category includes diamond engagement rings and wedding bands marketed to brides and grooms. Most jewelry in this category is constructed of platinum, although gold was used as the primary metal in approximately 5% of sales. Most sales in this category are of items containing diamonds. The average price of merchandise sold in 2011, 2010 and 2009 in this category was approximately \$3,800, \$3,400 and \$3,200 for total reportable segments.
- c) This category generally consists of non-gemstone, sterling silver (approximately 70% of the category in 2011) or gold jewelry, although small gemstones are used as accents in some pieces. This category does not include jewelry that bears a designer's name. The average price of merchandise sold in 2011, 2010 and 2009 in this category was approximately \$250, \$220 and \$210 for total reportable segments.
- d) This category generally consists of platinum, gold and sterling silver jewelry, some of which contains diamonds, other gemstones or a combination of both diamonds and other gemstones. This category includes only items that bear the name of and are attributed to one of the Company's named designers: Elsa Peretti, Paloma Picasso, Frank Gehry and Jean Schlumberger (refer to MATERIAL DESIGNER LICENSE below). The average price of merchandise sold in 2011, 2010 and 2009 in this category was approximately \$520, \$450 and \$420 for total reportable segments.

Certain reclassifications within the jewelry categories have been made to the prior years' amounts to conform to the current year category presentation.

ADVERTISING AND MARKETING

The Registrant regularly advertises, primarily in newspapers and magazines, and also increasingly through digital media, and periodically conducts product marketing events. In 2011, 2010 and 2009, the Registrant spent \$234,050,000 (6.4% of net sales), \$197,597,000 (6.4% of net sales) and \$159,891,000 (5.9% of net sales) on worldwide advertising, which include costs for media, production, catalogs, Internet, visual merchandising (in-store and window displays), marketing events and other related items.

PUBLIC AND MEDIA RELATIONS

Public and media relations activities are significant to the Registrant's business and are important in maintaining the Brand. The Company engages in a program of media activities and retail marketing events to maintain consumer awareness of the Brand and TIFFANY & CO. products. Each year, Tiffany publishes its well-known *Blue Book* which showcases jewelry and other merchandise.

Management believes that the Brand is also enhanced by a program of charity sponsorships, grants and merchandise donations. In addition, the Company makes donations to The Tiffany & Co. Foundation, a private foundation organized to support 501(c)(3) charitable organizations. The efforts of this Foundation are concentrated in environmental conservation, urban parks and support for the decorative arts.

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TRADEMARKS

The designations TIFFANY® and TIFFANY & CO.® are the principal trademarks of Tiffany, as well as serving as tradenames. Through its subsidiaries, the Company has obtained and is the proprietor of trademark registrations for TIFFANY and TIFFANY & CO., as well as the TIFFANY BLUE BOX® and the color TIFFANY BLUE® for a variety of product categories in the U.S. and in other countries.

Tiffany maintains a program to protect its trademarks and institutes legal action where necessary to prevent others either from registering or using marks which are considered to create a likelihood of confusion with the Company or its products.

Tiffany has been generally successful in such actions and management considers that its worldwide trademark rights in TIFFANY and TIFFANY & CO. are strong. However, use of the designation TIFFANY by third parties (often small companies) on unrelated goods or services, frequently transient in nature, may not come to the attention of Tiffany or may not rise to a level of concern warranting legal action.

Tiffany actively pursues those who produce or sell counterfeit TIFFANY & CO. goods through civil action and cooperation with criminal law enforcement agencies. However, counterfeit TIFFANY & CO. goods remain available in many markets because it is not possible or cost-effective to fully address the problem. The cost of enforcement is expected to continue to rise. In recent years, there has been an increase in the availability of counterfeit goods, predominantly silver jewelry, in various markets by street vendors and small retailers and on the Internet. As Internet counterfeiting continues to become increasingly prolific, Tiffany has responded by engaging investigators and counsel to monitor the Internet and take various actions, including initiating civil proceedings against infringers and litigating through the Internet's Uniform Dispute Resolution Policy, to stop infringing activity.

Despite the general fame of the TIFFANY and TIFFANY & CO. name and mark for the Company's products and services, Tiffany is not the sole person entitled to use the name TIFFANY in every category in every country of the world; third parties have registered the name TIFFANY in the U.S. in the food services category, and in a number of foreign countries in respect of certain product categories (including, in a few countries, the categories of food, cosmetics, jewelry, clothing and tobacco products) under circumstances where Tiffany's rights were not sufficiently clear under local law, and/or where management concluded that Tiffany's foreseeable business interests did not warrant the expense of litigation.

MATERIAL DESIGNER LICENSE

Tiffany has been the sole licensee for jewelry designed by Elsa Peretti and bearing her trademark since 1974. The designs of Ms. Peretti accounted for 10% of the Company's net sales in 2011, 2010 and 2009. Ms. Peretti, age 71, retains ownership of copyrights for her designs and of her trademarks and exercises approval rights with respect to important aspects of the promotion, display, manufacture and merchandising of her designs. Tiffany is required by contract to devote a portion of its advertising budget to the promotion of her products and she is paid a royalty by Tiffany for jewelry and other items designed by her and sold under her name. A written agreement exists between Ms. Peretti and Tiffany, but it may be terminated by either party following six months notice to the other party. No arrangement is currently in place to continue the sale of designs following the death or disability of Ms. Peretti. Tiffany is the sole retail source for merchandise designed by Ms. Peretti worldwide; however, she has reserved by contract the right

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to appoint other distributors in markets outside the U.S., Canada, Japan, Singapore, Australia, Italy, the United Kingdom, Switzerland and Germany. The Registrant's operating results would be adversely affected were it to cease to be a licensee of Ms. Peretti or should its degree of exclusivity in respect of her designs be diminished.

MERCHANDISE PURCHASING, MANUFACTURING AND RAW MATERIALS

Tiffany produces jewelry and silver goods in New York, Rhode Island and Kentucky, and silver hollowware in New Jersey. Other subsidiaries of the Company process, cut and polish diamonds at facilities outside the U.S. In total, those manufacturing facilities produce approximately 60% of Tiffany merchandise sold. The balance, including almost all non-jewelry items, is purchased from third parties.

The Company may increase the percentage of internally-manufactured jewelry in the future, but it is not expected that Tiffany will ever manufacture all of its needs. Factors considered by management in its decision to outsource manufacturing include product quality, gross margin, access to or mastery of various jewelry-making skills and technology, support for alternative capacity and the cost of capital investments.

Purchases of Polished Gemstones and Precious Metals. Gemstones and precious metals used in making Tiffany's jewelry are purchased from a variety of sources. Most purchases are from suppliers with which Tiffany enjoys long-standing relationships.

The Company generally enters into purchase orders for fixed quantities with nearly all of its polished gemstone and precious metals vendors. These relationships may be terminated at any time by the Company without penalty; such termination would not discharge the Company's obligations under unfulfilled purchase orders placed prior to the termination.

The Company purchases precious metals for use in its U.S. internal manufacturing operations and for use in the manufacture of Tiffany merchandise by certain third-party vendors. While Tiffany may supply precious metals to those vendors, the finished goods made by such vendors may not exclusively contain Tiffany-purchased precious metals. Additionally, not all precious metals used by third-party vendors or in Tiffany's own manufacturing operations are sourced from a single mine or refinery. In recent years, there has been substantial volatility in the prices of precious metals.

Products containing one or more diamonds of varying sizes, including diamonds used as accents, side-stones and center-stones, accounted for approximately 55%, 52% and 48% of Tiffany's net sales in 2011, 2010 and 2009. Products containing one or more diamonds of one carat or larger accounted for 14%, 12% and 11% of net sales in each of those years.

Tiffany purchases polished diamonds principally from five key vendors. Were trade relations between Tiffany and one or more of these vendors to be disrupted, the Company's sales could be adversely affected in the short term until alternative supply arrangements could be established. In 2008 and early 2009, the economic environment led to a reduction of retail and wholesale demand, and rough diamond prices and wholesale polished prices both declined accordingly. In the second half of 2009, and throughout 2010 and 2011, a resumption of growth in industry-wide demand for rough and polished wholesale diamonds resulted in prices rising accordingly.

Some, but not all, of Tiffany's suppliers are Diamond Trading Company (DTC) shareholders (see "The DTC" below), and it is estimated that a significant portion of the diamonds that Tiffany has

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purchased have had their source with the DTC. The Company is a DTC sightholder for rough diamonds through its Antwerp operations and joint ventures (see below).

Except as noted above, Tiffany believes that there are numerous alternative sources for gemstones and precious metals and that the loss of any single supplier would not have a material adverse effect on its operations.

Purchases and Processing of Rough Diamonds. Of the world's largest diamond producing countries, the vast majority of diamonds purchased by Tiffany originate from Botswana, Canada, Namibia, South Africa, Sierra Leone, Russia and Australia. The Company has established diamond processing operations that purchase, sort, cut and/or polish rough diamonds for use by Tiffany. The Company has such operations in Belgium, South Africa, Botswana, Namibia, Mauritius and Vietnam. Operations in South Africa, Botswana and Namibia are conducted through joint venture companies in which third parties own minority interests. Tiffany maintains a relationship and has an arrangement with a single mine operator in each of these three southern African countries, although the Company may choose to supplement its current operations with alternative mine operators from time to time. The Company's operations in South Africa, Botswana and Namibia allow it to access rough diamond allocations reserved for local manufacturers.

Tiffany's purchases of conflict-free rough (see Conflict Diamonds below) and polished fine white diamonds, in the color ranges D through I and in sizes above 0.18 carats represent a significant portion of the world's supply of fine white diamonds in those color and size ranges. Management does not foresee a shortage of diamonds in those color and size ranges in the short term but believes that rising demand will eventually create such a shortage unless new mines are developed.

In recent years, approximately 50% - 60% of the polished diamonds acquired by Tiffany for use in jewelry have been produced from rough diamonds purchased by the Company. The balance of Tiffany's needs for polished diamonds have been purchased from third parties (see above). Through purchasing rough diamonds, it is the Company's intention to supply Tiffany's needs for diamonds to as great an extent as possible.

In order to acquire rough diamonds, the Company must purchase mixed assortments of rough diamonds. It is thus necessary to purchase some rough diamonds that cannot be cut to meet Tiffany's quality standards and that must be sold to third parties; such sales are reported in the Other non-reportable segment. To make such sales, the Company charges a market price and is, therefore, unable to earn any significant profit above its original cost. Sales of rough diamonds in the Other non-reportable segment have had and will continue to have the effect of reducing the Company's overall gross margins.

The Company will, from time to time, secure supplies of diamonds by agreeing to purchase a defined portion of a mine's output at the current market prices. Under such arrangements, management anticipates that it will purchase approximately \$200,000,000 of rough diamonds in 2012. The Company will also purchase rough diamonds from other suppliers, although there are no contractual obligations to do so.

The DTC. The supply and price of rough and polished diamonds in the principal world markets have been and continue to be influenced by the DTC, an affiliate of the De Beers Group. Although the market share of the DTC has diminished, the DTC continues to supply a significant portion of the world market for rough, gem-quality diamonds. The DTC's historical ability to control worldwide production has been significantly diminished due to its lower levels of production,

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changing policies in diamond-producing countries and revised contractual arrangements with third-party mine operators.

The DTC continues to exert influence on the demand for polished diamonds through the requirements it imposes on those (sightholders) who purchase rough diamonds from the DTC.

Worldwide Availability and Price of Diamonds. The availability and price of diamonds to the DTC, Tiffany and Tiffany s suppliers are dependent on a number of factors, including global consumer demand, the political situation in diamond-producing countries, the opening of new mines and the continuance of the prevailing supply and marketing arrangements for rough diamonds. As a consequence of changes in the DTC sightholder system and increased demand in the retail diamond trade, diamond prices increased significantly in the years leading up to 2008. During 2008 and early 2009, as global demand for rough diamonds waned due to economic conditions, diamond prices decreased but have increased again from the latter part of 2009 through 2011.

Sustained interruption in the supply of rough diamonds, an overabundance of supply or a substantial change in the marketing arrangements described above could adversely affect Tiffany and the retail jewelry industry as a whole. Changes in the marketing and advertising policies of the DTC and its direct purchasers could affect consumer demand for diamonds.

Conflict Diamonds. Media attention has been drawn to the issue of conflict or blood diamonds. These terms are used to refer to diamonds extracted from war-torn geographic regions and sold by rebel forces to fund insurrection. Allegations have also been made that trading in such diamonds supports terrorist activities. It is not considered possible to distinguish conflict diamonds from diamonds produced in other regions once they have been polished. Therefore, concerned participants in the diamond trade, including Tiffany and nongovernment organizations, such as the Responsible Jewellery Council of which Tiffany is a member, seek to exclude such diamonds, which represent a small fraction of the world s supply, from legitimate trade through an international system of certification and legislation known as the Kimberley Process Certification Scheme. All rough diamonds the Company buys must be accompanied by a Kimberley Process certificate and all subsequent trades of rough and polished diamonds must conform to a system of warranties that references the aforesaid scheme. It is not expected that such efforts will substantially affect the supply of diamonds. Concerns over human rights abuses in Zimbabwe underscore that the aforementioned system does not control diamonds produced in state-sanctioned mines under poor working conditions. Tiffany has informed its vendors that the Company does not intend to purchase Zimbabwean-produced diamonds.

Manufactured Diamonds. Manufactured diamonds are produced in small quantities. Although significant questions remain as to the ability of producers to produce manufactured diamonds economically within a full range of sizes and natural diamond colors, and as to consumer acceptance of manufactured diamonds, manufactured diamonds may someday become a larger factor in the market. Should manufactured diamonds be offered in significant quantities, the supply of and price for natural diamonds may be affected. Tiffany does not sell manufactured diamonds.

Finished Jewelry. Finished jewelry is purchased from approximately 70 manufacturers, most of which have long-standing relationships with Tiffany. However, Tiffany does not enter into long-term supply arrangements with its finished goods vendors. Tiffany does enter into written blanket purchase order agreements with nearly all of its finished goods vendors. These relationships may be terminated at any time by Tiffany without penalty; such termination would not discharge Tiffany s obligations under unfulfilled purchase orders placed prior to termination. The blanket purchase order agreements establish non-price terms by which Tiffany may purchase and by which vendors may sell finished goods to Tiffany. These terms include payment terms, shipping

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procedures, product quality requirements, merchandise specifications and vendor social responsibility requirements. Tiffany actively seeks alternative sources for its top-selling jewelry items to mitigate any potential disruptions in supply. However, due to the craftsmanship involved in a small number of designs, Tiffany may have difficulty finding readily available alternative suppliers for those jewelry designs in the short term.

Watches. Prior to 2007, the Company acquired TIFFANY & CO. brand watches from various Swiss manufacturers. In 2007, the Company entered into a 20-year license and distribution agreement with the Swatch Group for the manufacture and distribution of TIFFANY & CO. brand watches. Under the agreement, the Swatch Group incorporated a new watchmaking company in Switzerland for the design, engineering, manufacturing, marketing, distribution and service of TIFFANY & CO. brand watches. This watchmaking company is wholly-owned and controlled by the Swatch Group but is authorized by Tiffany to use certain trademarks owned by Tiffany and operate under the TIFFANY & CO. name as Tiffany Watch Co., Ltd. The distribution of TIFFANY & CO. watches is made through the Swatch Group distribution network via the Swatch Group's affiliates, the Swatch Group's retail facilities and third-party distributors and resulted in royalty revenue that was less than 1% of consolidated worldwide net sales in 2011 and 2010. Watches sold in TIFFANY & CO. stores constituted 1% of consolidated worldwide net sales in 2011, 2010 and 2009. See Item 3. Legal Proceedings for additional information.

COMPETITION

The global jewelry industry is competitively fragmented. The Company encounters significant competition in all product lines. Some competitors specialize in just one area in which the Company is active. Many competitors have established worldwide, national or local reputations for style, quality, expertise and customer service similar