

Fossil Group, Inc.
Form 10-Q
November 12, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: October 3, 2015

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 number: 000-19848

FOSSIL GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	75-2018505 (I.R.S. Employer Identification No.)
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901 S. Central Expressway, Richardson, Texas (Address of principal executive offices) (972) 234-2525 (Registrant's telephone number, including area code)	75080 (Zip Code)
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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer Accelerated filer

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

Smaller reporting company

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

The number of shares of the registrant's common stock outstanding as of November 5, 2015: 48,118,839

PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

FOSSIL GROUP, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 UNAUDITED
 IN THOUSANDS

	October 3, 2015	January 3, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$301,569	\$276,261
Accounts receivable - net of allowances of \$63,559 and \$80,047, respectively	330,396	430,498
Inventories	746,343	597,281
Deferred income tax assets-net	36,667	34,084
Prepaid expenses and other current assets	150,059	151,730
Total current assets	1,565,034	1,489,854
Property, plant and equipment - net of accumulated depreciation of \$387,322 and \$360,191, respectively	330,420	345,606
Goodwill	197,252	197,728
Intangible and other assets-net	162,171	174,364
Total long-term assets	689,843	717,698
Total assets	\$2,254,877	\$2,207,552
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$180,698	\$159,267
Short-term and current portion of long-term debt	21,722	16,646
Accrued expenses:		
Compensation	60,554	50,776
Royalties	35,620	54,013
Co-op advertising	18,125	28,591
Transaction taxes	19,965	35,301
Other	83,420	75,609
Income taxes payable	13,428	26,626
Total current liabilities	433,532	446,829
Long-term income taxes payable	13,554	16,610
Deferred income tax liabilities	87,645	87,860
Long-term debt	785,706	613,659
Other long-term liabilities	50,798	58,793
Total long-term liabilities	937,703	776,922
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Common stock, 48,117 and 50,771 shares issued and outstanding at October 3, 2015 and January 3, 2015, respectively	481	508
Additional paid-in capital	182,974	171,669
Retained earnings	743,572	822,093
Accumulated other comprehensive income (loss)	(57,235)	(16,410)
Total Fossil Group, Inc. stockholders' equity	869,792	977,860

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Noncontrolling interest	13,850	5,941
Total stockholders' equity	883,642	983,801
Total liabilities and stockholders' equity	\$2,254,877	\$2,207,552

See notes to the condensed consolidated financial statements.

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FOSSIL GROUP, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
 UNAUDITED
 IN THOUSANDS, EXCEPT PER SHARE DATA

	For the 13 Weeks Ended October 3, 2015	For the 13 Weeks Ended October 4, 2014	For the 39 Weeks Ended October 3, 2015	For the 40 Weeks Ended October 4, 2014
Net sales	\$771,303	\$894,482	\$2,236,363	\$2,444,846
Cost of sales	353,569	385,444	1,008,439	1,047,986
Gross profit	417,734	509,038	1,227,924	1,396,860
Operating expenses:				
Selling, general and administrative expenses	338,888	354,105	1,003,931	1,052,471
Restructuring charges	3,141	—	21,700	—
Total operating expenses	342,029	354,105	1,025,631	1,052,471
Operating income	75,705	154,933	202,293	344,389
Interest expense	5,103	3,796	14,295	11,389
Other income (expense) - net	6,830	2,198	28,310	751
Income before income taxes	77,432	153,335	216,308	333,751
Provision for income taxes	17,303	46,931	58,721	103,286
Net income	60,129	106,404	157,587	230,465
Less: Net income attributable to noncontrolling interest	2,595	2,683	7,335	7,884
Net income attributable to Fossil Group, Inc.	\$57,534	\$103,721	\$150,252	\$222,581
Other comprehensive income (loss), net of taxes:				
Currency translation adjustment	\$(7,435)	\$(43,479)	\$(35,382)	\$(43,080)
Derivative instruments-net change	(5,258)	11,773	(5,443)	11,361
Pension plan activity	—	—	—	(3,293)
Total other comprehensive income (loss)	(12,693)	(31,706)	(40,825)	(35,012)
Total comprehensive income	47,436	74,698	116,762	195,453
Less: Comprehensive income attributable to noncontrolling interest	2,595	2,683	7,335	7,884
Comprehensive income attributable to Fossil Group, Inc.	\$44,841	\$72,015	\$109,427	\$187,569
Earnings per share:				
Basic	\$1.19	\$1.97	\$3.06	\$4.16
Diluted	\$1.19	\$1.96	\$3.06	\$4.15
Weighted average common shares outstanding:				
Basic	48,153	52,691	49,027	53,454
Diluted	48,242	52,871	49,148	53,653

See notes to the condensed consolidated financial statements.

FOSSIL GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
UNAUDITED
IN THOUSANDS

	For the 39 Weeks Ended October 3, 2015	For the 40 Weeks Ended October 4, 2014	
Operating Activities:			
Net income	\$157,587	\$230,465	
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, amortization and accretion	63,421	73,477	
Stock-based compensation	13,997	14,238	
Decrease in allowance for returns-net of inventory in transit	(7,981	) (727)
Loss on disposal of assets	2,164	643	
Impairment losses	5,587	6,083	
Non-cash restructuring charges	2,381	—	
Decrease in allowance for doubtful accounts	(1,867	) (351)
Excess tax benefits from stock-based compensation	(176	) (885)
Deferred income taxes and other	7,458	(1,144)
Contingent consideration remeasurement	(114	) 1,112	
Changes in operating assets and liabilities, net of effect of acquisitions:			
Accounts receivable	103,259	48,385	
Inventories	(172,746	) (146,141)
Prepaid expenses and other current assets	(20,669	) (49,220)
Accounts payable	17,871	33,216	
Accrued expenses	(18,618	) (26,840)
Income taxes payable	(17,064	) 15,600	
Net cash provided by operating activities	134,490	197,911	
Investing Activities:			
Additions to property, plant and equipment	(53,171	) (70,792)
Increase in intangible and other assets	(737	) (11,586)
Skagen Designs arbitration settlement	5,968	—	
Business acquisitions-net of cash acquired	(4,820) —	
Net investment hedge settlement	—	410	
Net cash used in investing activities	(52,760	) (81,968)
Financing Activities:			
Acquisition of common stock	(231,220	) (321,224)
Distribution of noncontrolling interest earnings and other	(5,257	) (5,392)
Excess tax benefits from stock-based compensation	176	885	
Debt borrowings	1,867,550	637,000	
Debt payments	(1,691,139	) (522,172)
Proceeds from exercise of stock options	658	1,922	
Other financing activities	(2,097	) (1,942)
Net cash used in financing activities	(61,329	) (210,923)
Effect of exchange rate changes on cash and cash equivalents	4,907	(7,404)
Net increase (decrease) in cash and cash equivalents	25,308	(102,384)
Cash and cash equivalents:			
Beginning of period	276,261	320,479	

End of period	\$301,569	\$218,095
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See notes to the condensed consolidated financial statements.

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FOSSIL GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
UNAUDITED

1. FINANCIAL STATEMENT POLICIES

Basis of Presentation. The condensed consolidated financial statements include the accounts of Fossil Group, Inc., a Delaware corporation, and its wholly and majority-owned subsidiaries (the “Company”).

The condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary to present a fair statement of the Company’s financial position as of October 3, 2015, and the results of operations for the thirteen-week periods ended October 3, 2015 (“Third Quarter”) and October 4, 2014 (“Prior Year Quarter”), respectively, and the thirty-nine week period ended October 3, 2015 (“Year To Date Period”) and the forty week period ended October 4, 2014 (“Prior Year YTD Period”). All adjustments are of a normal, recurring nature. The Company’s fiscal year periodically results in a 53-week year instead of a normal 52-week year. The prior fiscal year ended January 3, 2015 was a 53-week year, with the additional week included in the first quarter of the fiscal year. Accordingly, the information presented herein includes thirty-nine weeks of operations for the Year To Date Period as compared to forty weeks included in the Prior Year YTD Period.

Effective during the first quarter of the current fiscal year, the Company made changes to the presentation of its reportable segments to reflect changes in the way its chief operating decision maker evaluates the performance of its operations, develops strategy and allocates capital resources. The Company has realigned its operating structure. Strategic and brand directions are set centrally and regional management is now fully empowered and responsible to drive those strategies and brand directions across all brands and channels within their regions. As part of the new operating structure, the regional teams manage both the wholesale and retail businesses within their regions whereas previously the retail business was managed globally. Additionally, with the implementation of new reporting systems, the Company has the ability to extract discrete financial information that aligns with its operating structure and is consistent with how management now evaluates the business performance. The Company’s reportable segments now consist of the following: (i) Americas, (ii) Europe and (iii) Asia. Prior to the Company’s first quarter fiscal 2015 Form 10-Q, as reported in the 2014 Form 10-K (as defined below), the Company’s reportable segments consisted of the following: (i) North America wholesale, (ii) Europe wholesale, (iii) Asia Pacific wholesale and (iv) Direct to consumer.

These changes to the Company’s reportable segments include the following:

- (1) Reclassification of the Company’s retail, e-commerce and catalog activities, all of which were previously recorded within the Company’s Direct to consumer segment, to the Americas, Europe and Asia segments based on the geographic location of the activities.
- (2) The Company’s wholesale operations in North America, Europe and Asia Pacific previously recorded within the North America wholesale, Europe wholesale and Asia Pacific wholesale segments, respectively, have been reclassified to the Americas, Europe and Asia segments, respectively.
- (3) Intercompany profit attributable to the Company’s factory operations was previously included in the Asia Pacific wholesale and Europe wholesale segments in accordance with the geographic location of the factories, and is now eliminated from all reporting segments.
- (4) Certain corporate costs are not allocated to the various segments because they are managed at the corporate level for internal purposes. Prior to the change in reporting segments, these expenses included, and after the change in

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reporting segments, continue to include, general corporate expenses, including certain administrative, legal, accounting, technology support costs, equity compensation costs and payroll costs attributable to executive management. Additionally, certain brand management, product development, art, creative/product design, marketing and back office supply chain expenses which were previously included in North America wholesale, Europe wholesale, Asia Pacific wholesale and Direct to consumer segments prior to the change in reporting segments are now reported in corporate. Conversely, certain back office costs reported in corporate prior to the change in reporting segments are now included in the various reporting segments in which they are now managed.

The Company's historical segment disclosures have been recast to be consistent with the current presentation.

These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Annual Report on Form 10-K filed by the Company pursuant to the

Securities Exchange Act of 1934, as amended (the “Exchange Act”), for the fiscal year ended January 3, 2015 (the “2014 Form 10-K”). Operating results for the Third Quarter and Year To Date Period are not necessarily indicative of the results to be achieved for the full fiscal year.

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”), which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the periods reported. Actual results could differ from those estimates. The Company has not made any changes in its significant accounting policies from those disclosed in the 2014 Form 10-K. Certain prior year amounts have been reclassified to conform to the current year presentation.

Business. The Company is a global design, marketing and distribution company that specializes in consumer fashion accessories. Its principal offerings include an extensive line of men’s and women’s fashion watches and jewelry, handbags, small leather goods, belts, sunglasses, soft accessories and select apparel. In the watch and jewelry product categories, the Company has a diverse portfolio of globally recognized owned and licensed brand names under which its products are marketed. The Company’s products are distributed globally through various distribution channels, including wholesale in countries where it has a physical presence, direct to the consumer through its retail stores and commercial websites and through third-party distributors in countries where the Company does not maintain a physical presence. The Company’s products are offered at varying price points to meet the needs of its customers, whether they are value-conscious or luxury oriented. Based on its extensive range of accessory products, brands, distribution channels and price points, the Company is able to target style-conscious consumers across a wide age spectrum on a global basis.

Hedging Instruments. The Company is exposed to certain market risks relating to foreign exchange rates and interest rates. The Company actively monitors and attempts to manage these exposures using derivative instruments including foreign exchange forward contracts (“forward contracts”) and interest rate swaps. The Company’s foreign subsidiaries periodically enter into forward contracts to hedge the future payment of intercompany inventory transactions denominated in U.S. dollars. If the Company was to settle its euro, British pound, Canadian dollar, Japanese yen, Australian dollar and Mexican peso forward contracts as of October 3, 2015, the net result would have been a net gain of approximately \$10.7 million, net of taxes. To help protect against adverse existing and forecasted fluctuations in interest rates, the Company has entered into interest rate swap agreements to effectively convert portions of its existing and forecasted variable rate debt obligations to fixed rates. To reduce exposure to changes in currency exchange rates adversely affecting the Company’s investment in foreign currency-denominated subsidiaries, the Company periodically enters into forward contracts designated as net investment hedges. The Company does not hold or issue derivative financial instruments for trading or speculative purposes. See “Note 10—Derivatives and Risk Management” for additional disclosures about the Company’s use of derivatives.

Operating expenses. Operating expenses include selling, general and administrative expenses (“SG&A”) and restructuring charges. SG&A expenses include selling and distribution expenses primarily consisting of sales and distribution labor costs, sales distribution center and warehouse facility costs, depreciation expense related to sales distribution and warehouse facilities, the four-wall operating costs of the Company’s retail stores, point-of-sale expenses, advertising expenses and art, design and product development labor costs. SG&A also includes general and administrative expenses primarily consisting of administrative support labor and “back office” or support costs such as treasury, legal, information services, accounting, internal audit, human resources, executive management costs and costs associated with stock-based compensation. Restructuring charges include costs to reorganize, refine and optimize the Company’s infrastructure and store closures. See “Note 15—Restructuring” for additional information on the Company’s restructuring plan.

Earnings Per Share (“EPS”). Basic EPS is based on the weighted average number of common shares outstanding during each period. Diluted EPS adjusts basic EPS for the effects of dilutive common stock equivalents outstanding during each period using the treasury stock method.

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The following table reconciles the numerators and denominators used in the computations of both basic and diluted EPS (in thousands, except per share data):

	For the 13 Weeks Ended October 3, 2015	For the 13 Weeks Ended October 4, 2014	For the 39 Weeks Ended October 3, 2015	For the 40 Weeks Ended October 4, 2014
Numerator:				
Net income attributable to Fossil Group, Inc.	\$57,534	\$103,721	\$150,252	\$222,581
Denominator:				
Basic EPS computation:				
Basic weighted average common shares outstanding	48,153	52,691		