

SKECHERS USA INC
Form 10-Q
November 09, 2011
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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 September 30, 2011

OR

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

For the transition period from _____ to _____

Commission File Number 001-14429

SKECHERS U.S.A., INC.

(Exact name of registrant as specified in its charter)

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| | |
|---|--|
| Delaware (State or Other Jurisdiction of Incorporation or Organization) | 95-4376145 (I.R.S. Employer Identification No.) |
| 228 Manhattan Beach Blvd. Manhattan Beach, California (Address of Principal Executive Office) | 90266 (Zip Code) |
| (310) 318-3100 (Registrant's Telephone Number, Including Area Code) | |

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 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

Non-accelerated filer 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 CLASS A COMMON STOCK OUTSTANDING AS OF NOVEMBER 1, 2011: 38,593,996.

THE NUMBER OF SHARES OF CLASS B COMMON STOCK OUTSTANDING AS OF NOVEMBER 1, 2011: 11,296,970.

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SKECHERS U.S.A., INC. AND SUBSIDIARIES

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****SKECHERS U.S.A., INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands, except par values)**

| | September 30, 2011 | December 31, 2010 |
|--|-------------------------------|------------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 247,974 | \$ 233,558 |
| Trade accounts receivable, net | 244,977 | 266,057 |
| Other receivables | 7,136 | 9,650 |
| | | |
| Total receivables | 252,113 | 275,707 |
| Inventories, net | 238,360 | 398,588 |
| Prepaid expenses and other current assets | 78,168 | 53,791 |
| Deferred tax assets | 11,720 | 11,720 |
| | | |
| Total current assets | 828,335 | 973,364 |
| Property and equipment, at cost, less accumulated depreciation and amortization | 382,418 | 293,802 |
| Intangible assets, less accumulated amortization | 6,192 | 7,367 |
| Deferred tax assets | 12,323 | 12,323 |
| Other assets, at cost | 19,037 | 17,938 |
| | | |
| TOTAL ASSETS | \$ 1,248,305 | \$ 1,304,794 |
| LIABILITIES AND EQUITY | | |
| Current Liabilities: | | |
| Current installments of long-term borrowings | \$ 9,974 | \$ 11,984 |
| Short-term borrowings | 49,368 | 18,346 |
| Accounts payable | 145,635 | 246,595 |
| Accrued expenses | 21,055 | 30,385 |
| | | |
| Total current liabilities | 226,032 | 307,310 |
| Long-term borrowings, excluding current installments | 78,974 | 51,650 |
| Deferred tax liabilities | 73 | 0 |
| | | |
| Total liabilities | 305,079 | 358,960 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred Stock, \$.001 par value; 10,000 authorized; none issued and outstanding | 0 | 0 |
| Class A Common Stock, \$.001 par value; 100,000 shares authorized; 37,155 and 36,894 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively | 37 | 37 |
| Class B Common Stock, \$.001 par value; 100,000 shares authorized; 11,297 and 11,311 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively | 11 | 11 |
| Additional paid-in capital | 317,016 | 303,877 |

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| | | |
|---|---------------------|---------------------|
| Accumulated other comprehensive income (loss) | (2,298) | 4,265 |
| Retained earnings | 590,190 | 600,013 |
| Skechers U.S.A., Inc. equity | 904,956 | 908,203 |
| Non-controlling interests | 38,270 | 37,631 |
| Total equity | 943,226 | 945,834 |
| TOTAL LIABILITIES AND EQUITY | \$ 1,248,305 | \$ 1,304,794 |

See accompanying notes to unaudited condensed consolidated financial statements.

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SKECHERS U.S.A., INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands, except per share data)

| | Three-Months Ended September 30, | | Nine-Months Ended September 30, | |
|--|----------------------------------|------------|---------------------------------|--------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net sales | \$ 412,183 | \$ 554,626 | \$ 1,322,768 | \$ 1,552,249 |
| Cost of sales | 236,988 | 301,975 | 811,633 | 824,535 |
| Gross profit | 175,195 | 252,651 | 511,135 | 727,714 |
| Royalty income | 1,406 | 1,888 | 4,430 | 3,148 |
| | 176,601 | 254,539 | 515,565 | 730,862 |
| Operating expenses: | | | | |
| Selling | 37,943 | 59,516 | 128,602 | 146,262 |
| General and administrative | 136,364 | 139,455 | 418,312 | 389,241 |
| | 174,307 | 198,971 | 546,914 | 535,503 |
| Earnings (loss) from operations | 2,294 | 55,568 | (31,349) | 195,359 |
| Other income (expense): | | | | |
| Interest income | 217 | 487 | 1,559 | 2,350 |
| Interest expense | (1,203) | (3) | (5,519) | (835) |
| Other, net | 395 | (3,143) | (200) | (1,323) |
| | (591) | (2,659) | (4,160) | 192 |
| Earnings (loss) before income taxes | 1,703 | 52,909 | (35,509) | 195,551 |
| Income tax (benefit) expense | (6,653) | 16,330 | (25,966) | 62,532 |
| Net earnings (loss) | 8,356 | 36,579 | (9,543) | 133,019 |
| Less: Net earnings attributable to non-controlling interests | 71 | 201 | 280 | 108 |
| Net earnings (loss) attributable to Skechers U.S.A., Inc. | \$ 8,285 | \$ 36,378 | \$ (9,823) | \$ 132,911 |
| Net earnings (loss) per share attributable to Skechers U.S.A., Inc.: | | | | |
| Basic | \$ 0.17 | \$ 0.76 | \$ (0.20) | \$ 2.81 |
| Diluted | \$ 0.17 | \$ 0.74 | \$ (0.20) | \$ 2.71 |
| Weighted average shares used in calculating earnings (loss) per share attributable to Skechers U.S.A., Inc.: | | | | |
| Basic | 48,445 | 47,586 | 48,344 | 47,268 |

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| | | | | | | | | |
|--|----|----------|----|--------|----|----------|----|---------|
| Diluted | | 49,399 | | 49,176 | | 48,344 | | 49,017 |
| Comprehensive income (loss): | | | | | | | | |
| Net earnings (loss) | \$ | 8,285 | \$ | 36,378 | \$ | (9,823) | \$ | 132,911 |
| Gain (loss) on foreign currency translation adjustment, net of tax | | (15,507) | | 10,372 | | (6,563) | | (44) |
| Total comprehensive income (loss) | \$ | (7,222) | \$ | 46,750 | \$ | (16,386) | \$ | 132,867 |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**SKECHERS U.S.A., INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

| | Nine-Months Ended September 30, | |
|---|--|-----------------|
| | 2011 | 2010 |
| Cash flows from operating activities: | | |
| Net (loss) earnings | \$ (9,823) | \$ 132,911 |
| Adjustments to reconcile net earnings (loss) to net cash provided by operating activities: | | |
| Non-controlling interest in subsidiaries | 280 | 108 |
| Depreciation of property and equipment | 22,923 | 17,641 |
| Amortization of deferred financing costs | 890 | 1,111 |
| Amortization of intangible assets | 1,185 | 1,287 |
| Provision for bad debts and returns | 4,556 | 4,663 |
| Non-cash stock compensation | 10,804 | 10,136 |
| Loss on disposal of equipment | 256 | 42 |
| Deferred income taxes | 76 | (19) |
| Decrease (increase) in assets: | | |
| Receivables | 15,427 | (63,355) |
| Inventories | 158,629 | (101,911) |
| Prepaid expenses and other current assets | (24,838) | (18,681) |
| Other assets | (1,934) | (7,342) |
| (Decrease) increase in liabilities: | | |
| Accounts payable | (98,099) | 32,332 |
| Accrued expenses | (8,574) | (9,642) |
| Net cash provided by (used in) operating activities | 71,758 | (719) |
| Cash flows from investing activities: | | |
| Capital expenditures | (114,299) | (65,617) |
| Maturities of investments | 0 | 30,000 |
| Intangible additions | 0 | (40) |
| Net cash (used in) investing activities | (114,299) | (35,657) |
| Cash flows from financing activities: | | |
| Net proceeds from the issuances of stock through employee stock purchase plan and the exercise of stock options | 2,101 | 11,527 |
| Increase in long-term borrowings | 37,179 | 0 |
| Payments on long-term debt | (11,795) | (576) |
| Increase in short-term borrowings | 30,939 | 281 |
| Contribution from non-controlling interest of consolidated entity | 115 | 1,000 |
| Excess tax benefits from stock-based compensation | 234 | 7,389 |
| Net cash provided by financing activities | 58,773 | 19,621 |
| Net increase (decrease) in cash and cash equivalents | 16,232 | (16,755) |
| Effect of exchange rates on cash and cash equivalents | (1,816) | (92) |
| Cash and cash equivalents at beginning of the period | 233,558 | 265,675 |

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| | | | | |
|--|----|---------|----|---------|
| Cash and cash equivalents at end of the period | \$ | 247,974 | \$ | 248,828 |
| Supplemental disclosures of cash flow information: | | | | |
| Cash paid during the period for: | | | | |
| Interest | \$ | 3,952 | \$ | 1,830 |
| Income taxes | | 9,559 | | 82,941 |
| Non-cash transactions: | | | | |
| Land contribution from noncontrolling interest of consolidated entity | | 0 | | 30,000 |
| Note payable contribution from noncontrolling interest of consolidated entity | | 0 | | 16,032 |
| See accompanying notes to unaudited condensed consolidated financial statements. | | | | |

Table of Contents**SKECHERS U.S.A., INC. AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****SEPTEMBER 30, 2011 and 2010****(Unaudited)****(1) GENERAL***Basis of Presentation*

The accompanying condensed consolidated financial statements of Skechers U.S.A., Inc. (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include certain footnotes and financial presentations normally required under accounting principles generally accepted in the United States of America for complete financial reporting. The interim financial information is unaudited, but reflects all normal and recurring adjustments and accruals which are, in the opinion of management, considered necessary to provide a fair presentation for the interim periods presented. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010.

The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2011.

Use of Estimates

The preparation of the condensed consolidated financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Non-controlling interests

The Company has interests in certain joint ventures which are consolidated into its financial statements. Net earnings attributable to non-controlling interest was income of \$0.1 million and \$0.2 million for the three months ended September 30, 2011 and 2010, respectively, which represents the share of net earnings that is attributable to our joint venture partners. Net earnings attributable to non-controlling interest was income of \$0.3 million and \$0.1 million for the nine months ended September 30, 2011 and 2010, respectively.

The Company has determined that its joint venture with HF Logistics I, LLC (HF) is a variable interest entity (VIE) and that the Company is the primary beneficiary. The VIE is consolidated into the condensed consolidated financial statements and the carrying amounts and classification of assets and liabilities were as follows (in thousands):

| | September 30, 2011 | December 31, 2010 |
|--------------------------|---------------------------|--------------------------|
| Current assets | \$ 5,128 | \$ 6,058 |
| Noncurrent assets | 134,131 | 107,723 |
| Total assets | \$ 139,259 | \$ 113,781 |
| Current liabilities | \$ 60,986 | \$ 36,364 |
| Noncurrent liabilities | 18,193 | 17,359 |
| Total liabilities | \$ 79,179 | \$ 53,723 |

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The assets of these joint ventures are restricted in that they are not available for our general business use outside the context of the joint venture. The holders of the liabilities of each joint venture have no recourse to Skechers U.S.A., Inc. The Company does not have a significant variable interest in any unconsolidated VIE s.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, (ASU 2011-05). ASU 2011-05 eliminates the option to report other comprehensive income and its components in the statement of changes in equity. ASU 2011-05 requires that all non-owner changes in stockholders' equity be presented in either a single continuous statement of comprehensive income or in two separate but consecutive statements. This new guidance is to be applied retrospectively. ASU 2011-05 is effective for annual periods beginning after December 15, 2011. We do not expect that the adoption of this standard update will have a material impact on the Company's consolidated financial statements.

(2) REVENUE RECOGNITION

The Company recognizes revenue on wholesale sales when products are shipped and the customer takes title and assumes risk of loss, collection of relevant receivable is reasonably assured, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. This generally occurs at time of shipment. The Company recognizes revenue from retail sales at the point of sale. Allowances for estimated returns, discounts, doubtful accounts and chargebacks are provided when related revenue is recorded. Related costs paid to third-party shipping companies are recorded as a cost of sales.

Royalty income is earned from licensing arrangements. Upon signing a new licensing agreement, we receive up-front fees, which are generally characterized as prepaid royalties. These fees are initially deferred and recognized as revenue as earned (i.e., as licensed sales are reported to the company or on a straight-line basis over the term of the agreement). The first calculated royalty payment is based on actual sales of the licensed product. Typically, at each quarter-end we receive correspondence from our licensees indicating the actual sales for the period. This information is used to calculate and accrue the related royalties based on the terms of the agreement.

(3) OTHER COMPREHENSIVE INCOME (LOSS)

In addition to net earnings (loss), other comprehensive income (loss) includes changes in foreign currency translation adjustments and income (loss) attributable to non-controlling interests. The Company operates internationally through several foreign subsidiaries. Assets and liabilities of the foreign operations denominated in local currencies are translated at the rate of exchange at the balance sheet date. Revenues and expenses are translated at the weighted average rate of exchange during the period of translation. The resulting translation adjustments along with translation adjustments related to intercompany loans of a long-term nature are included in the translation adjustment in other comprehensive income (loss).

The activity in other comprehensive income (loss), net of income taxes, was as follows (in thousands):

| | Three-Months Ended September 30, | | Nine-Months Ended September 30, | |
|---|----------------------------------|------------------|---------------------------------|-------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Comprehensive income (loss) | | | | |
| Net earnings (loss) | \$ 8,356 | \$ 36,579 | \$ (9,543) | \$ 133,019 |
| Gain (loss) on foreign currency translation adjustment, net of tax | (15,644) | 10,543 | (6,319) | 197 |
| Comprehensive income (loss) | (7,288) | 47,122 | (15,862) | 133,216 |
| Comprehensive income (loss) attributable to noncontrolling interest | (66) | 372 | 524 | 349 |
| Comprehensive income (loss) attributable to parent | \$ (7,222) | \$ 46,750 | \$ (16,386) | \$ 132,867 |

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For stock-based awards we have recognized compensation expense based on the grant date fair value. Share-based compensation expense was \$3.6 million and \$3.5 million for the three months ended September 30, 2011 and 2010, respectively. Share-based compensation expense was \$10.8 million and \$10.1 million for the nine months ended September 30, 2011 and 2010, respectively.

Stock options granted pursuant to the 1998 Stock Option, Deferred Stock and Restricted Stock Plan and the 2007 Incentive Award Plan (the Equity Incentive Plans) were as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|-----------------------------------|-----------|---------------------------------------|---|---------------------------------|
| Outstanding at December 31, 2010 | 451,308 | \$ 11.26 | | |
| Granted | 0 | 0 | | |
| Exercised | (104,635) | 9.11 | | |
| Cancelled | (85,808) | 23.10 | | |
| Outstanding at September 30, 2011 | 260,865 | 8.23 | 1.2 years | \$ 1,512,210 |
| Exercisable at September 30, 2011 | 260,865 | 8.23 | 1.2 years | \$ 1,512,210 |

A summary of the status and changes of our nonvested shares related to our Equity Incentive Plans as of and for the nine months ended September 30, 2011 is presented below:

| | Shares | Weighted Average Grant-Date Fair Value |
|---------------------------------|-----------|--|
| Nonvested at December 31, 2010 | 1,493,329 | \$ 18.97 |
| Granted | 10,000 | 21.00 |
| Vested | (49,167) | 30.94 |
| Cancelled | (15,333) | 17.43 |
| Nonvested at September 30, 2011 | 1,438,829 | 18.59 |

As of September 30, 2011, there was \$14.9 million of unrecognized compensation cost related to nonvested common shares. The cost is expected to be amortized over a weighted average period of 1.2 years.

(5) EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share represents net earnings (loss) divided by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share represents the weighted average number of common shares and potential common shares, if dilutive, that would arise from the exercise of stock options and nonvested shares using the treasury stock method.

The following is a reconciliation of net earnings (loss) and weighted average common shares outstanding for purposes of calculating basic earnings (loss) per share (in thousands, except per share amounts):

| Basic earnings (loss) per share | Three-Months Ended September 30, Nine-Months Ended September 30, | | | |
|---------------------------------|--|------|------|------|
| | 2011 | 2010 | 2011 | 2010 |

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| | | | | |
|---|----------|-----------|------------|------------|
| Net earnings (loss) attributable to Skechers U.S.A., Inc. | \$ 8,285 | \$ 36,378 | \$ (9,823) | \$ 132,911 |
| Weighted average common shares outstanding | 48,445 | 47,586 | 48,344 | 47,268 |
| Basic earnings (loss) per share attributable to Skechers U.S.A., Inc. | \$ 0.17 | \$ 0.76 | \$ (0.20) | \$ 2.81 |

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The following is a reconciliation of net earnings (loss) and weighted average common shares outstanding for purposes of calculating diluted earnings (loss) per share (in thousands, except per share amounts):

| Diluted earnings (loss) per share | Three-Months Ended September 30, 2011 | | Nine-Months Ended September 30, 2010 | |
|---|---------------------------------------|-----------|--------------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net earnings (loss) attributable to Skechers U.S.A., Inc. | \$ 8,285 | \$ 36,378 | \$ (9,823) | \$ 132,911 |
| Weighted average common shares outstanding | 48,445 | 47,586 | 48,344 | 47,268 |
| Dilutive effect of stock options | 954 | 1,590 | 0 | 1,749 |
| Weighted average common shares outstanding | 49,399 | 49,176 | 48,344 | 49,017 |
| Diluted earnings (loss) per share attributable to Skechers U.S.A., Inc. | \$ 0.17 | \$ 0.74 | \$ (0.20) | \$ 2.71 |

There were no options excluded from the computation of diluted earnings per share for the three months ended September 30, 2011. Options to purchase 25,816 shares of Class A common stock were not included in the computation of diluted earnings (loss) per share for the nine months ended September 30, 2011, because their effect would have been anti-dilutive. There were no options excluded from the computation of diluted earnings per share for the three months and nine months ended September 30, 2010, respectively.

(6) INCOME TAXES

The Company's effective tax rates for the third quarter and first nine months of 2011 were (390.7)% and 73.1%, respectively, compared to the effective tax rates of 30.9% and 32.0% for the third quarter and first nine months of 2010, respectively. Income tax benefit for the three months ended September 30, 2011 was \$6.7 million compared to expense of \$16.3 million for the same period in 2010. Income tax benefit for the nine months ended September 30, 2011 was \$26.0 million compared to expense of \$62.5 million for the same period in 2010. The effective tax rates for the third quarter and first nine months of 2011 included a \$4.6 million benefit recorded for prior year research and development tax credit claims made in the third quarter.

(7) LINE OF CREDIT, SHORT-TERM AND LONG-TERM BORROWINGS

The Company and its subsidiaries had \$2.8 million of outstanding letters of credit and short-term borrowings of \$49.4 million as of September 30, 2011 and \$18.3 million at December 31, 2010.

Long-term debt is as follows (in thousands):

| | September 30, 2011 | December 31, 2010 |
|---|--------------------|-------------------|
| Note payable to bank, due in monthly installments of \$531.4 (includes principal and interest), fixed-rate interest at 3.54%, secured by property, balloon payment of \$12,635 due December 2015 | \$ 35,542 | \$ 39,325 |
| Note payable to bank, due in monthly installments of \$483.9 (includes principal and interest), fixed-rate interest at 3.19%, secured by property, balloon payment of \$11,670 due June 2016 | 35,179 | 0 |
| Note payable to bank, due in monthly installments of \$57.6 (includes principal and interest), fixed-rate interest at 7.89%, secured by property, balloon payment of \$6,889 paid in January 2011 | 0 | 6,900 |
| Loan from HF Logistics I, LLC | 18,193 | 17,358 |
| Capital lease obligations | 34 | 51 |
| Subtotal | 88,948 | 63,634 |
| Less current installments | 9,974 | 11,984 |
| Total long-term debt | \$ 78,974 | \$ 51,650 |

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(8) LITIGATION

The Company's claims and advertising for its toning products including for its Shape-ups are subject to the requirements of, and routinely come under review by regulators including the U.S. Federal Trade Commission (FTC), states' Attorneys General and government and quasi-government regulators in foreign countries. The Company is currently responding to requests for information regarding its claims and advertising from regulatory and quasi-regulatory agencies in the United States and several other countries and are fully cooperating with those requests. While the Company believes that its claims and advertising with respect to its core toning products are supported by scientific tests, expert opinions and other relevant data, and while the Company has been successful in defending its claims and advertising in several different countries, the Company has discontinued using certain test results and periodically reviews and updates its claims and advertising. The regulatory inquiries may conclude in a variety of outcomes, including the closing of the inquiry with no further regulatory action, settlement of any issues through changes in its claims and advertising, settlement of any issues through payment to the regulatory entity, or litigation.

Based on discussions with the FTC staff, the Company does not believe that the FTC's pending inquiry into the Company's toning products will likely end in a closure letter assuring no further regulatory action. The FTC's Director of the Bureau of Consumer Protection has referred the matter to the FTC Commissioners for consideration of whether to bring an action against the Company for false and deceptive advertising in connection with its toning products. The Company intends to defend this matter vigorously and will be meeting with each Commissioner in the fourth quarter to present evidence and arguments against filing a complaint. The Company notes that one of its competitors, which also sells toning products, recently settled a matter with the FTC and related consumer class actions regarding the claims and advertising of its toning products for the payment of \$25 million, plus an additional \$4.6 million in attorneys' fees. While the Company believes that the facts with regard to the FTC inquiry into the Company's toning products and its consumer class actions are different from its competitor's, it is reasonably possible that the Company could be subject to a comparable, or higher, exposure as a result of these proceedings.

In accordance with U.S. GAAP, the Company records a liability in its consolidated financial statements for loss contingencies when a loss is known or considered probable and the amount can be reasonably estimated. When determining the estimated loss or range of loss, significant judgment is required to estimate the amount and timing of a loss to be recorded. Estimates of probable losses resulting from litigation and governmental proceedings are inherently difficult to predict, particularly when the matters are in the procedural stages or with unspecified or indeterminate claims for damages, potential penalties, or fines. As it is still too early in the process to predict the final outcomes of the FTC inquiry into the Company's toning products or any other pending inquiries (or any resulting regulatory action) or the related consumer class actions, we cannot conclude that a loss related to the outcomes of these proceedings is probable and cannot reasonably estimate the range of loss, if any, that may result from these matters at this time. Consequently, the Company has not accrued a loss in connection with these matters. While it is not possible to predict the outcomes of the FTC inquiry, any other pending inquiries, or the related consumer class actions, it is possible that costs associated with them could have a material adverse impact on the Company's consolidated earnings, financial position, or cash flows.

(9) STOCKHOLDERS' EQUITY

During the three months ended September 30, 2011, no shares of Class B common stock were converted into shares of Class A common stock. During the nine months ended September 30, 2011, 13,640 shares of Class B common stock were converted into shares of Class A common stock. During the three months and nine months ended September 30, 2010, 34,900 and 1,049,005 shares of Class B common stock were converted into shares of Class A common stock, respectively.

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The following table reconciles equity attributable to non-controlling interest (in thousands):

| | Nine-Months Ended September 30, | |
|---|--|------------------|
| | 2011 | 2010 |
| Non-controlling interest, January 1 | \$ 37,631 | \$ 3,448 |
| Net earnings attributable to non-controlling interest | 280 | 108 |
| Foreign currency translation adjustment | 244 | 241 |
| Capital contribution by non-controlling interest | 115 | 31,000 |
| Non-controlling interest, September 30 | \$ 38,270 | \$ 34,797 |

(10) SEGMENT AND GEOGRAPHIC REPORTING INFORMATION

We have four reportable segments – domestic wholesale sales, international wholesale sales, retail sales, and e-commerce sales. Management evaluates segment performance based primarily on net sales and gross profit. All other costs and expenses of the Company are analyzed on an aggregate basis, and these costs are not allocated to the Company's segments. Net sales, gross profit and identifiable assets and additions to property and equipment for the domestic wholesale segment, international wholesale, retail, and the e-commerce segment on a combined basis were as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|---|-------------------|--|---------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net sales: | | | | |
| Domestic wholesale | \$ 162,516 | \$ 312,319 | \$ 591,292 | \$ 904,066 |
| International wholesale | 133,792 | 124,623 | 408,205 | 325,751 |
| Retail | 111,484 | 111,825 | 307,847 | 301,410 |
| E-commerce | 4,391 | 5,859 | 15,424 | 21,022 |
| Total | \$ 412,183 | \$ 554,626 | \$ 1,322,768 | \$ 1,552,249 |

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|---|-------------------|--|-------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Gross margins | | | | |
| Domestic wholesale | \$ 56,969 | \$ 129,496 | \$ 160,823 | \$ 387,478 |
| International wholesale | 54,045 | 52,070 | 166,689 | 138,073 |
| Retail | 62,079 | 68,043 | 175,939 | 191,156 |
| E-commerce | 2,102 | 3,042 | 7,684 | 11,007 |
| Total | \$ 175,195 | \$ 252,651 | \$ 511,135 | \$ 727,714 |

| | September 30, 2011 | December 31, 2010 |
|-----------------------------|---------------------------|--------------------------|
| Identifiable assets: | | |
| Domestic wholesale | \$ 813,248 | \$ 891,671 |
| International wholesale | 303,064 | 300,153 |
| Retail | 131,747 | 112,774 |
| E-commerce | 246 | 196 |
| Total | \$ 1,248,305 | \$ 1,304,794 |

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------------|----------------------------------|------------------|---------------------------------|------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Additions to property and equipment: | | | | |
| Domestic wholesale | \$ 12,175 | \$ 30,443 | \$ 90,959 | \$ 47,185 |
| International wholesale | 1,006 | 521 | 2,830 | 3,113 |
| Retail | 8,237 | 4,932 | 20,510 | 15,319 |
| Total | \$ 21,418 | \$ 35,896 | \$ 114,299 | \$ 65,617 |

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Geographic Information:

The following summarizes our operations in different geographic areas for the period indicated (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-------------------------|----------------------------------|-------------------|---------------------------------|---------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net sales: (1) | | | | |
| United States | \$ 263,383 | \$ 416,577 | \$ 870,780 | \$ 1,193,410 |
| Canada | 13,643 | 17,472 | 41,161 | 45,347 |
| Other international (2) | 135,157 | 120,577 | 410,827 | 313,492 |
| Total | \$ 412,183 | \$ 554,626 | \$ 1,322,768 | \$ 1,552,249 |

| | September 30, 2011 | December 31, 2010 |
|-------------------------|--------------------|-------------------|
| Long-lived assets: | | |
| United States | \$ 364,582 | \$ 276,457 |
| Canada | 1,275 | 1,590 |
| Other international (2) | 16,561 | 15,755 |
| Total | \$ 382,418 | \$ 293,802 |

- (1) The Company has subsidiaries in Canada, United Kingdom, Germany, France, Spain, Portugal, Italy, Netherlands, Brazil, and Chile that generate net sales within those respective countries and in some cases the neighboring regions. The Company has joint ventures in China, Hong Kong, Malaysia, Singapore, and Thailand that generate net sales from those countries. The Company also has a subsidiary in Switzerland that generates net sales from that country in addition to net sales to our distributors located in numerous non-European countries. Net sales are attributable to geographic regions based on the location of the Company subsidiary.
- (2) Other international consists of Switzerland, United Kingdom, Germany, Austria, France, Spain, Portugal, Italy, Netherlands, China, Hong Kong, Malaysia, Singapore, Thailand, Brazil, Chile, Vietnam, and Japan.

(11) BUSINESS AND CREDIT CONCENTRATIONS

The Company generates the majority of its sales in the United States; however, several of its products are sold into various foreign countries, which subjects the Company to the risks of doing business abroad. In addition, the Company operates in the footwear industry, which is impacted by the general economy, and its business depends on the general economic environment and levels of consumer spending. Changes in the marketplace may significantly affect management's estimates and the Company's performance. Management performs regular evaluations concerning the ability of customers to satisfy their obligations and provides for estimated doubtful accounts. Domestic accounts receivable, which generally do not require collateral from customers, were equal to \$115.6 million and \$164.4 million before allowances for bad debts, sales returns and chargebacks at September 30, 2011 and December 31, 2010, respectively. Foreign accounts receivable, which in some cases are collateralized by letters of credit, were equal to \$150.1 million and \$121.4 million before allowance for bad debts, sales returns and chargebacks at September 30, 2011 and December 31, 2010, respectively. The Company's credit losses attributable to write-offs for the three months ended September 30, 2011 and 2010 were \$0.3 million and \$2.2 million, respectively. The Company's credit losses attributable to write-offs for the nine months ended September 30, 2011 and 2010 were \$2.8 million and \$3.8 million, respectively.

Assets located outside the U.S. consist primarily of cash, accounts receivable, inventory, property and equipment, and other assets. Net assets held outside the United States were \$325.3 million and \$322.0 million at September 30, 2011 and December 31, 2010, respectively.

The Company's net sales to its five largest customers accounted for approximately 17.4% and 26.0% of total net sales for the three months ended September 30, 2011 and 2010, respectively. The Company's net sales to its five largest customers accounted for approximately 18.8% and 27.2% of total net sales for the nine months ended September 30, 2011 and 2010, respectively. No customer accounted for more than 10% of our net sales during the

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three months ended September 30, 2011 and 2010, respectively. No customer accounted for more than 10% of our net sales during the nine months ended September 30, 2011 and 2010, respectively. No customer accounted for more than 10% of our outstanding accounts receivable balance at September 30, 2011 and December 31, 2010, respectively.

The Company's top five manufacturers produced the following for the three and nine months ended September 30, 2011 and 2010, respectively:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------|----------------------------------|-------|---------------------------------|-------|
| | 2011 | 2010 | 2011 | 2010 |
| Manufacturer #1 | 24.5% | 36.3% | 29.5% | 35.4% |
| Manufacturer #2 | 12.6% | 12.2% | 11.6% | 12.8% |
| Manufacturer #3 | 9.0% | 9.5% | 8.1% | 9.4% |
| Manufacturer #4 | 6.3% | 8.6% | 6.9% | 9.0% |
| Manufacturer #5 | 6.3% | 6.0% | 6.4% | 4.7% |
| | 58.7% | 72.6% | 62.5% | 71.3% |

The majority of the Company's products are produced in China. The Company's operations are subject to the customary risks of doing business abroad, including, but not limited to, currency fluctuations and revaluations, custom duties and related fees, various import controls and other monetary barriers, restrictions on the transfer of funds, labor unrest and strikes and, in certain parts of the world, political instability. The Company believes it has acted to reduce these risks by diversifying manufacturing among various factories. To date, these business risks have not had a material adverse impact on the Company's operations.

(12) RELATED PARTY TRANSACTIONS

On July 29, 2010, the Company formed Skechers Foundation (the "Foundation"), which is a 501(c)(3) non-profit entity that does not have any shareholders or members. The Foundation is not a subsidiary of and is not otherwise affiliated with the Company, and the Company does not have a financial interest in the Foundation. However, two officers and directors of the Company, Michael Greenberg who is its President and David Weinberg who is its Chief Operating Officer and Chief Financial Officer, are also officers and directors of the Foundation. The Company contributed \$250,000 and \$1.0 million to the Foundation to use for various charitable causes during the three months and nine months ended September 30, 2011, respectively.

(13) SUBSEQUENT EVENTS

The Company has entered into a tentative agreement to sell its distribution facility located in Ontario, California. The sale is expected to close during the fourth quarter of 2011. Assuming the sale is finalized, the Company expects to receive net sale proceeds of approximately \$17.1 million resulting in a pre-tax gain of approximately \$9.9 million.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our Condensed Consolidated Financial Statements and Notes thereto in Item 1 of this report and our company's annual report on Form 10-K for the year ended December 31, 2010.

We intend for this discussion to provide the reader with information that will assist in understanding our financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, as well as how certain accounting principles affect our financial statements. The discussion also provides information about the financial results of the various segments of our business to provide a better understanding of how those segments and their results affect the financial condition and results of operations of our company as a whole.

This quarterly report on Form 10-Q may contain forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which can be identified by the use of forward-looking language such as *intend, may, will, believe, expect, anticipate* or other comparable terms. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected in forward-looking statements, and reported results shall not be considered an indication of our company's future performance. Factors that might cause or contribute to such differences include:

international, national and local general economic, political and market conditions including the recent global economic recession and the uncertain pace of recovery in our markets;

our ability to maintain our brand image and to anticipate, forecast, identify, and respond to changes in fashion trends, consumer demand for the products and other market factors;

our ability to remain competitive among sellers of footwear for consumers, including in the highly competitive performance footwear market;

our ability to sustain, manage and forecast our costs and proper inventory levels;

the loss of any significant customers, decreased demand by industry retailers and the cancellation of order commitments;

our ability to continue to manufacture and ship our products that are sourced in China, which could be adversely affected by various economic, political or trade conditions, or a natural disaster in China;

our ability to predict our quarterly revenues, which have varied significantly in the past and can be expected to fluctuate in the future due to a number of reasons, many of which are beyond our control; and

other factors referenced or incorporated by reference in our company's annual report on Form 10-K for the year ended December 31, 2010 under the captions *Item 1A: Risk Factors* and *Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations*.

The risks included here are not exhaustive. Other sections of this report may include additional factors that could adversely impact our business, financial condition and results of operations. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and we cannot predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any factor or combination of factors may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements, which reflect our opinions only as of the date of this quarterly report, as a prediction of actual results. We undertake no obligation to publicly release any revisions

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to the forward-looking statements after the date of this document, except as otherwise required by reporting requirements of applicable federal and states securities laws.

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FINANCIAL OVERVIEW

Our net loss and gross margins for the first nine months of 2011 were negatively impacted by several factors, including (i) an excess supply of footwear in the toning market from all manufacturers, including our competitors, which led to (ii) sales of lower margin toning product through our domestic wholesale channel and (iii) lower retail margins due to sales price markdowns in order to reduce excess inventory levels of toning product. We anticipate our domestic revenues and margins will be lower for 2011 compared to 2010 as a result of the reduced demand and lower pricing of product in the toning category. We continue to closely monitor our inventory position of toning product, which we expect to continue to decline through the end of 2011 and into 2012. We believe that new styles and lines of footwear that we will be launching later this year will have an offsetting positive impact on our results of operations in 2012.

We have four reportable segments – domestic wholesale sales, international wholesale sales, retail sales, which includes domestic and international retail sales, and e-commerce sales. We evaluate segment performance based primarily on net sales and gross profit. The largest portion of our revenue is derived from the domestic wholesale segment. Net earnings for the three months ended September 30, 2011 was \$8.3 million, or \$0.17 per diluted share.

Revenue as a percentage of net sales was as follows:

| | Three-Months Ended September 30, | |
|-----------------------------------|---|-------------|
| | 2011 | 2010 |
| Percentage of revenues by segment | | |
| Domestic wholesale | 39.4% | 56.3% |
| International wholesale | 32.4% | 22.5% |
| Retail | 27.1% | 20.2% |
| E-commerce | 1.1% | 1.0% |
| Total | 100% | 100% |

As of September 30, 2011, we owned 272 domestic retail stores and 47 international retail stores, and we have established our presence in most of what we believe to be the major domestic retail markets. During the first nine months of 2011, we opened 15 domestic concept stores, eight domestic outlet stores, eight domestic warehouse stores, and four international concept stores and we closed one domestic concept store, one domestic warehouse store, and one international concept store. We annually review all of our stores for impairment, or more frequently if triggering events occur which may be an indicator of impairment, and we carefully review our under-performing stores and consider the potential for non-renewal of leases upon completion of the current term of the applicable lease.

During the remainder of 2011, we intend to focus on: (i) completing the transition to our new domestic distribution center, (ii) managing our inventory and expense structure to be in line with expected sales levels (iii) growing our international business, (iv) strategically expanding our retail distribution channel by opening another five to ten stores, including two international company-owned stores, and (v) increasing the product count for all customers by delivering trend-right styles at reasonable prices.

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RESULTS OF OPERATIONS

The following table sets forth for the periods indicated, selected information from our results of operations (in thousands) and as a percentage of net sales:

| | Three-Months Ended September 30, | | | | Nine-Months Ended September 30, | | | |
|--|----------------------------------|--------|------------|--------|---------------------------------|--------|--------------|--------|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| Net sales | \$ 412,183 | 100.0% | \$ 554,626 | 100.0% | \$ 1,322,768 | 100.0% | \$ 1,552,249 | 100.0% |
| Cost of sales | 236,988 | 57.5 | 301,975 | 54.4 | 811,633 | 61.4 | 824,535 | 53.1 |
| Gross profit | 175,195 | 42.5 | 252,651 | 45.6 | 511,135 | 38.6 | 727,714 | 46.9 |
| Royalty income | 1,406 | 0.3 | 1,888 | 0.3 | 4,430 | 0.3 | 3,148 | 0.2 |
| | 176,601 | 42.8 | 254,539 | 45.9 | 515,565 | 38.9 | 730,862 | 47.1 |
| Operating expenses: | | | | | | | | |
| Selling | 37,943 | 9.2 | 59,516 | 10.7 | 128,602 | 9.7 | 146,262 | 9.4 |
| General and administrative | 136,364 | 33.1 | 139,455 | 25.1 | 418,312 | 31.6 | 389,241 | 25.1 |
| | 174,307 | 42.3 | 198,971 | 35.8 | 546,914 | 41.3 | 535,503 | 34.5 |
| Earnings (loss) from operations | 2,294 | 0.5 | 55,568 | 10.1 | (31,349) | (2.4) | 195,359 | 12.6 |
| Interest income | 217 | 0.1 | 487 | 0.1 | 1,559 | 0.1 | 2,350 | 0.2 |
| Interest expense | (1,203) | (0.3) | (3) | 0 | (5,519) | (0.4) | (835) | (0.1) |
| Other, net | 395 | 0.1 | (3,143) | (0.7) | (200) | 0 | (1,323) | (0.1) |
| Earnings (loss) before income taxes | 1,703 | 0.4 | 52,909 | 9.5 | (35,509) | (2.7) | 195,551 | 12.6 |
| Income tax (benefit) expense | (6,653) | (1.6) | 16,330 | 2.9 | (25,966) | (2.0) | 62,532 | 4.0 |
| Net earnings (loss) | 8,356 | 2.0 | 36,579 | 6.6 | (9,543) | (0.7) | 133,019 | 8.6 |
| Less: Net income attributable to non-controlling interests | 71 | 0 | 201 | 0 | 280 | 0 | 108 | 0 |
| Net earnings (loss) attributable to Skechers U.S.A., Inc. | \$ 8,285 | 2.0% | \$ 36,378 | 6.6% | \$ (9,823) | (0.7)% | \$ 132,911 | 8.6% |

THREE MONTHS ENDED SEPTEMBER 30, 2011 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2010

Net sales

Net sales for the three months ended September 30, 2011 were \$412.2 million, a decrease of \$142.4 million, or 25.7%, as compared to net sales of \$554.6 million for the three months ended September 30, 2010. The decrease in net sales was primarily attributable to lower sales in our domestic wholesale segment due to reduced sales of toning products partially offset by higher sales in our international wholesale segment.

Our domestic wholesale net sales decreased \$149.8 million, or 48.0%, to \$162.5 million for the three months ended September 30, 2011 from \$312.3 million for the three months ended September 30, 2010. The largest decrease in our domestic wholesale segment came in our women's and men's toning divisions. The average selling price per pair within the domestic wholesale segment decreased to \$22.04 per pair for the three months ended September 30, 2011 from \$25.87 per pair in the same period last year due to reduced sales of toning product in comparison to the prior year. The decrease in the domestic wholesale segment's net sales resulted from a 38.9% unit sales volume decrease to 7.4 million pairs for the three months ended September 30, 2011 from 12.1 million pairs for the same period in 2010.

Our international wholesale segment sales increased \$9.2 million, or 7.4%, to \$133.8 million for the three months ended September 30, 2011 compared to sales of \$124.6 million for the three months ended September 30, 2010. Our international wholesale sales consist of direct

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subsidiary sales those we make to department stores and specialty retailers and sales to our distributors, who in turn sell to retailers in various international regions where we do not sell directly. Direct subsidiary sales increased \$6.0 million, or 6.4%, to \$99.6 million for the three months ended September 30, 2011 compared to net sales of \$93.6 million for the three months ended September 30, 2010. The largest sales increases during the quarter came from our subsidiaries in Italy and Spain. Our distributor sales increased \$3.2 million to \$34.2 million for the three months ended September 30, 2011, a 10.3% increase from sales

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of \$31.0 million for the three months ended September 30, 2010. This was primarily attributable to increased sales to our distributors in Panama and Taiwan.

Our retail segment sales decreased \$0.3 million to \$111.5 million for the three months ended September 30, 2011, a 0.3% decrease from sales of \$111.8 million for the three months ended September 30, 2010. The decrease in retail sales was attributable to negative comparable store sales for our domestic stores partially offset by a net increase of 44 total stores. For the three months ended September 30, 2011, we realized negative comparable store sales of 10.6% in our domestic retail stores and 0.3% in our international retail stores. The comparable store sales decline domestically was principally driven by reduced demand for our toning product as well as reduced average retail pricing as described above. During the three months ended September 30, 2011, we opened two new domestic concept stores, three domestic outlet stores, six domestic warehouse stores, and three international concept stores. Our domestic retail sales decreased 2.0% for the three months ended September 30, 2011 compared to the same period in 2010 as the result of negative comparable store sales partially offset by a net increase of 37 domestic stores. Our international retail sales increased 11.8% for the three months ended September 30, 2011 compared to the same period in 2010 attributable to a net increase of seven international stores partially offset by negative comparable store sales.

Our e-commerce sales decreased \$1.5 million from \$5.9 million for the three months ended September 30, 2010 to \$4.4 million for the three months ended September 30, 2011, a 25.1% decrease. Our e-commerce sales made up approximately 1% of our consolidated net sales for each of the three-month periods ended September 30, 2011 and 2010.

Gross profit

Gross profit for the three months ended September 30, 2011 decreased \$77.4 million to \$175.2 million as compared to \$252.6 million for the three months ended September 30, 2010. Gross profit as a percentage of net sales, or gross margin, decreased to 42.5% for the three months ended September 30, 2011 from 45.6% for the same period in the prior year. Our domestic wholesale segment gross profit decreased \$72.5 million, or 56.0%, to \$57.0 million for the three months ended September 30, 2011 compared to \$129.5 million for the three months ended September 30, 2010, which was attributable to lower sales volumes. Domestic wholesale margins decreased to 35.1% in the three months ended September 30, 2011 from 41.5% for the same period in the prior year. The decrease in domestic wholesale margins was primarily attributable to lower average selling prices.

Gross profit for our international wholesale segment increased \$1.9 million, or 3.8%, to \$54.0 million for the three months ended September 30, 2011 compared to \$52.1 million for the three months ended September 30, 2010. Gross margins were 40.4% for the three months ended September 30, 2011 compared to 41.8% for the three months ended September 30, 2010. The decrease in gross margins for the international wholesale segment was attributable to increased distributor sales, which achieved lower gross margins than our international wholesale sales through our foreign subsidiaries. Gross margins for our direct subsidiary sales were 45.3% for the three months ended September 30, 2011 as compared to 46.8% for the three months ended September 30, 2010. Gross margins for our distributor sales were 26.2% for the three months ended September 30, 2011 as compared to 26.7% for the three months ended September 30, 2010.

Gross profit for our retail segment decreased \$5.9 million, or 8.8%, to \$62.1 million for the three months ended September 30, 2011 as compared to \$68.0 million for the three months ended September 30, 2010. Gross margins for all stores were 55.7% for the three months ended September 30, 2011 as compared to 60.9% for the three months ended September 30, 2010. Gross margins for our domestic stores were 55.6% for the three months ended September 30, 2011 as compared to 60.8% for the three months ended September 30, 2010. Gross margins for our international stores were 56.6% for the three months ended September 30, 2011 as compared to 61.5% for the three months ended September 30, 2010. The decrease in domestic retail margins was primarily due to lower average selling prices and negative comparable sales.

Our cost of sales includes the cost of footwear purchased from our manufacturers, royalties, duties, quota costs, inbound freight (including ocean, air and freight from the dock to our distribution centers), broker fees and storage

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costs. Because we include expenses related to our distribution network in general and administrative expenses while some of our competitors may include expenses of this type in cost of sales, our gross margins may not be comparable, and we may report higher gross margins than some of our competitors in part for this reason.

Selling expenses

Selling expenses decreased by \$21.6 million, or 36.3%, to \$37.9 million for the three months ended September 30, 2011 from \$59.5 million for the three months ended September 30, 2010. As a percentage of net sales, selling expenses were 9.2% and 10.7% for the three months ended September 30, 2011 and 2010, respectively. The decrease in selling expenses was primarily the result of lower advertising expenses.

Selling expenses consist primarily of the following: sales representative sample costs, sales commissions, trade shows, advertising and promotional costs, which may include television, print ads, ad production costs and point-of-purchase (POP) costs.

General and administrative expenses

General and administrative expenses decreased by \$3.1 million, or 2.2%, to \$136.4 million for the three months ended September 30, 2011 from \$139.5 million for the three months ended September 30, 2010. As a percentage of sales, general and administrative expenses were 33.1% and 25.1% for the three months ended September 30, 2011 and 2010, respectively. The decrease in general and administrative expenses was primarily attributable to decreased salaries of \$2.8 million and lower bad debt expense of \$2.1 million. In addition, the expenses related to our distribution network, including purchasing, receiving, inspecting, allocating, warehousing and packaging of our products, totaled \$30.9 million for both the three months ended September 30, 2011 and 2010, respectively.

General and administrative expenses consist primarily of the following: salaries, wages and related taxes and various overhead costs associated with our corporate staff, stock-based compensation, domestic and international retail operations, non-selling related costs of our international operations, costs associated with our domestic and European distribution centers, professional fees related to legal, consulting and accounting, insurance, depreciation and amortization, and expenses related to our distribution network, which includes the functions of purchasing, receiving, inspecting, allocating, warehousing and packaging our products. These costs are included in general and administrative expenses and are not allocated to segments.

Interest income

Interest income was \$0.2 million for the three months ended September 30, 2011 compared to \$0.5 million for the same period in 2010.

Interest expense

Interest expense increased \$1.2 million for the three months ended September 30, 2011 compared to the same period in 2010. The increase was attributable to increased interest paid to our foreign manufacturers.

Income taxes

Our effective tax rate was (390.7)% and 30.9% for the three months ended September 30, 2011 and 2010, respectively. Income tax benefit for the three months ended September 30, 2011 was \$6.7 million compared to expense of \$16.3 million for the same period in 2010. The effective tax rate for the third quarter of 2011 included a \$4.6 million benefit recorded for prior year research and development tax credit claims made in the third quarter.

After the first quarter of 2011, estimating a reliable annual effective tax rate for our company for the year became increasingly difficult because of the uncertainty in forecasting taxable income or loss for the remainder of the year for each of our domestic and international operations. Such forecasts may vary significantly from quarter to quarter and even small changes in forecasts or actual results for either our domestic or international operations can result in

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significant changes in our estimated annual effective tax rate. Since forecasting an annual effective tax rate under these circumstances would not provide a meaningful estimate, we believe that the actual year-to-date effective tax rate is the best estimate of the annual tax rate in accordance with ASC 740-270. Our income tax benefit has been calculated utilizing our actual effective tax rate for the nine month period ended September 30, 2011.

Non-controlling interest in net income of consolidated subsidiaries

Non-controlling interest for the three months ended September 30, 2011 decreased \$0.1 million to income of \$0.1 million as compared to \$0.2 million for the same period in 2010. Non-controlling interest represents the share of net earnings that is attributable to our joint venture partners.

NINE MONTHS ENDED SEPTEMBER 30, 2011 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2010***Net sales***

Net sales for the nine months ended September 30, 2011 were \$1.322 billion, a decrease of \$229.5 million, or 14.8%, as compared to net sales of \$1.552 billion for the nine months ended September 30, 2010. The decrease in net sales was primarily attributable to lower sales in our domestic wholesale segment due to reduced sales of toning products and lower average selling prices for our products partially offset by higher sales in our international wholesale segment.

Our domestic wholesale net sales decreased \$312.8 million, or 34.6%, to \$591.3 million for the nine months ended September 30, 2011, from \$904.1 million for the nine months ended September 30, 2010. The largest decrease in our domestic wholesale segment came in our women's and men's toning divisions. The average selling price per pair within the domestic wholesale segment decreased to \$20.16 per pair for the nine months ended September 30, 2011 from \$24.81 per pair in the same period last year, as a result of the sell-through of our excess toning inventory. The decrease in the domestic wholesale segment's net sales also resulted from a 19.5% unit sales volume decrease to 29.3 million pairs for the nine months ended September 30, 2011 from 36.4 million pairs for the same period in 2010.

Our international wholesale segment sales increased \$82.5 million, or 25.3%, to \$408.2 million for the nine months ended September 30, 2011, compared to sales of \$325.7 million for the nine months ended September 30, 2010. Direct subsidiary sales increased \$50.0 million, or 20.1%, to \$298.9 million for the nine months ended September 30, 2011 compared to net sales of \$248.9 million for the nine months ended September 30, 2010. The largest sales increases during the nine months came from our subsidiaries in Italy, Spain, and United Kingdom. Our distributor sales increased \$32.5 million to \$109.3 million for the nine months ended September 30, 2011, a 42.2% increase from sales of \$76.8 million for the nine months ended September 30, 2010. This was primarily attributable to increased sales to our distributors in Panama, Japan, the United Arab Emirates (UAE), and Korea.

Our retail segment sales increased \$6.4 million to \$307.8 million for the nine months ended September 30, 2011, a 2.1% increase over sales of \$301.4 million for the nine months ended September 30, 2010. The increase in retail sales was attributable to a net increase of 44 total stores partially offset by negative comparable store sales for our domestic stores. For the nine months ended September 30, 2011, we realized negative comparable store sales of 10.7% in our domestic retail stores and positive comparable store sales of 1.6% in our international retail stores. The comparable store sales decline domestically was principally driven by reduced demand for our toning product as well as reduced average retail pricing as described above. During the nine months ended September 30, 2011, we opened 15 new domestic concept stores, eight domestic outlet stores, eight domestic warehouse stores, four international concept stores, and we closed one domestic concept store, one domestic warehouse store, and one international concept store. Our domestic retail sales decreased 1.6% for the nine months ended September 30, 2011 compared to the same period in 2010 as the result of negative comparable store sales partially offset by a net increase of 37 domestic stores. Our international retail sales increased 32.3% for the nine months ended September 30, 2011 compared to the same period in 2010 attributable to a net increase of seven international stores.

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Our e-commerce sales decreased \$5.6 million from \$21.0 million for the nine months ended September 30, 2010 to \$15.4 million for the nine months ended September 30, 2011, a 26.6% decrease. Our e-commerce sales made up approximately 1% of our consolidated net sales for each of the nine-month periods ended September 30, 2011 and 2010.

Gross profit

Gross profit for the nine months ended September 30, 2011 decreased \$216.6 million to \$511.1 million as compared to \$727.7 million for the nine months ended September 30, 2010. Gross profit as a percentage of net sales, or gross margin, decreased to 38.6% for the nine months ended September 30, 2011 from 46.9% for the same period in the prior year. Our domestic wholesale segment gross profit decreased \$226.7 million, or 58.5%, to \$160.8 million for the nine months ended September 30, 2011 compared to \$387.5 million for the nine months ended September 30, 2010. Domestic wholesale margins decreased to 27.2% in the nine months ended September 30, 2011 from 42.9% for the same period in the prior year. The decrease in domestic wholesale margins was primarily attributable to lower sales volumes and lower average selling prices due to the sell-through of our excess toning inventory. In the second quarter of 2011, we reduced our excess toning inventory by selling two million pairs of our original Shape-ups at a loss of \$21.0 million and recorded an additional \$4.4 million reserve for our remaining toning product.

Gross profit for our international wholesale segment increased \$28.6 million, or 20.7%, to \$166.7 million for the nine months ended September 30, 2011 compared to \$138.1 million for the nine months ended September 30, 2010. Gross margins were 40.8% for the nine months ended September 30, 2011 compared to 42.4% for the nine months ended September 30, 2010. The decrease in gross margins for the international wholesale segment was attributable to increased distributor sales, which achieved lower gross margins than our international wholesale sales through our foreign subsidiaries. Gross margins for our direct subsidiary sales were 46.4% for the nine months ended September 30, 2011 as compared to 46.8% for the nine months ended September 30, 2010. Gross margins for our distributor sales were 25.7% for the nine months ended September 30, 2011 as compared to 28.2% for the nine months ended September 30, 2010.

Gross profit for our retail segment decreased \$15.3 million, or 8.0%, to \$175.9 million for the nine months ended September 30, 2011 as compared to \$191.2 million for the nine months ended September 30, 2010. Gross margins for all stores were 57.2% for the nine months ended September 30, 2011 as compared to 63.4% for the nine months ended September 30, 2010. Gross margins for our domestic stores were 57.4% for the nine months ended September 30, 2011 as compared to 63.5% for the nine months ended September 30, 2010. Gross margins for our international stores were 55.5% for the nine months ended September 30, 2011 as compared to 63.0% for the nine months ended September 30, 2010. The decrease in domestic retail margins was primarily due to lower average selling prices and negative comparable sales.

Selling expenses

Selling expenses decreased by \$17.7 million, or 12.1%, to \$128.6 million for the nine months ended September 30, 2011 from \$146.3 million for the nine months ended September 30, 2010. As a percentage of net sales, selling expenses were 9.7% and 9.4% for the nine months ended September 30, 2011 and 2010, respectively. The decrease in selling expenses was primarily the result of lower advertising expenses.

General and administrative expenses

General and administrative expenses increased by \$29.1 million, or 7.5%, to \$418.3 million for the nine months ended September 30, 2011 from \$389.2 million for the nine months ended September 30, 2010. As a percentage of sales, general and administrative expenses were 31.6% and 25.1% for the nine months ended September 30, 2011 and 2010, respectively. The increase in general and administrative expenses was primarily attributable to higher rent expense of \$8.8 million attributable to an additional 44 stores from the prior year, increased outside professional fees of \$8.2 million, and increased depreciation expense of \$5.2 million. In addition, the expenses related to our distribution network, including purchasing, receiving, inspecting, allocating, warehousing and packaging of our

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products, totaled \$97.8 million and \$89.6 million for the nine months ended September 30, 2011 and 2010, respectively.

Interest income

Interest income was \$1.6 million for the nine months ended September 30, 2011 compared to \$2.4 million for the same period in 2010. The decrease in interest income was primarily attributable to interest received on refunds of customs and duties payments for the nine months ended September 30, 2010.

Interest expense

Interest expense was \$5.5 million for the nine months ended September 30, 2011 compared to \$0.8 million for the same period in 2010. The increase was attributable to increased interest paid to our foreign manufacturers.

Income taxes

Our effective tax rate was 73.1% and 32.0% for the nine months ended September 30, 2011 and 2010, respectively. Income tax benefit for the nine months ended September 30, 2011 was \$26.0 million compared to expense of \$62.5 million for the same period in 2010. The effective tax rate for the first nine months of 2011 included a \$4.6 million benefit recorded for prior year research and development tax credit claims made in the third quarter.

After the first quarter of 2011, estimating a reliable annual effective tax rate for our company for the year became increasingly difficult because of the uncertainty in forecasting taxable income or loss for the remainder of the year for each of our domestic and international operations. Such forecasts may vary significantly from quarter to quarter and even small changes in forecasts or actual results for either our domestic or international operations can result in significant changes in our company's estimated annual effective tax rate. Since forecasting an annual effective tax rate under these circumstances would not provide a meaningful estimate, we believe that the actual year-to-date effective tax rate is the best estimate of the annual tax rate in accordance with ASC 740-270. Our income tax benefit has been calculated utilizing our actual effective tax rate for the nine month period ended September 30, 2011.

Non-controlling interest in net income of consolidated subsidiaries

Non-controlling interest for the nine months ended September 30, 2011 increased \$0.2 million to income of \$0.3 million as compared to \$0.1 million for the same period in 2010.

LIQUIDITY AND CAPITAL RESOURCES

Our working capital at September 30, 2011 was \$602.3 million, a decrease of \$63.8 million from working capital of \$666.1 million at December 31, 2010. Our cash and cash equivalents at September 30, 2011 were \$248.0 million compared to \$233.6 million at December 31, 2010. The increase in cash and cash equivalents of \$14.4 million was the result of reduced inventory levels of \$158.6 million and increased borrowings of \$68.1 million, partially offset by capital expenditures of \$114.3 million and decreased payables of \$98.1 million.

For the nine months ended September 30, 2011, net cash provided by operating activities was \$71.8 million as compared to net cash used of \$0.7 million for the nine months ended September 30, 2010. The increase in net cash provided by operating activities in the nine months ended September 30, 2011 as compared to the same period in the prior year was the result of reduced inventory levels and lower receivable balances, partially offset by reduced earnings and decreased payables.

Net cash used in investing activities was \$114.3 million for the nine months ended September 30, 2011 as compared to \$35.7 million for the nine months ended September 30, 2010. The increase in net cash used in investing activities in the nine months ended September 30, 2011 as compared to the same period in the prior year

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was the result of increased capital expenditures and the maturity of short-term investments in the prior year. Capital expenditures for the nine months ended September 30, 2011 were approximately \$114.3 million, which consisted of \$41.0 million of development costs for our new distribution center, \$44.2 million in warehouse equipment upgrades, and \$20.5 million for new store openings and remodels. Capital expenditures for the nine months ended September 30, 2010 were \$65.6 million, which primarily consisted of new store openings and remodels and development costs for our new distribution center. During the third quarter we began the process of moving into our new distribution facility in Rancho Belago, California and we expect to be substantially moved into by the end of the year. During the next six months, we are expecting additional cash receipts of approximately \$78.2 million of which approximately \$61.1 million is due to tax refunds of U.S. Federal and state tax overpayments, net operating loss carrybacks and research and development tax credits. In addition, we expect to receive sale proceeds from our Ontario, California distribution center of approximately \$17.1 million which we expect to close during the fourth quarter of 2011. We expect the sale of this facility to generate a pre-tax \$9.9 million gain. Excluding the costs of our new distribution center and distribution equipment, we expect our ongoing capital expenditures for the remainder of 2011 to be approximately \$5 million to \$10 million, which includes opening an additional five to ten retail stores along with store remodels. We believe our operating cash flows, current cash, available lines of credit and current financing arrangements should be adequate to fund these capital expenditures, although we may seek additional funding for all or a portion of these expenditures.

Net cash provided by financing activities was \$58.8 million during the nine months ended September 30, 2011 compared to \$19.6 million during the nine months ended September 30, 2010. The increase in cash provided by financing activities in the nine months ended September 30, 2011 as compared to the same period in the prior year was primarily attributable to increased borrowings.

On December 29, 2010, we entered into a master loan and security agreement (the Master Agreement), by and between us and Banc of America Leasing & Capital, LLC, and an Equipment Security Note (together with the Master Agreement, the Loan Documents), by and among us, Banc of America Leasing & Capital, LLC, and Bank of Utah, as agent (Agent). We used the proceeds to refinance certain equipment already purchased and to purchase new equipment for use in our Rancho Belago distribution facility. Borrowings made pursuant to the Master Agreement may be in the form of one or more equipment security notes (each a Note, and, collectively, the Notes) up to a maximum limit of \$80.0 million and each for a term of 60 months. The Note entered into on the same date as the Master Agreement represents a borrowing of approximately \$39.3 million. Interest will accrue at a fixed rate of 3.54% per annum. On June 30, 2011, we entered into another Note agreement for approximately \$36.3 million. Interest will accrue at a fixed rate of 3.19% per annum. As of September 30, 2011, the total outstanding amount on these notes was \$70.7 million. We paid commitment fees of \$825,000 on this loan, which are being amortized over the five-year life of the facility.

On April 30, 2010, we entered into a construction loan agreement (the Loan Agreement), by and between HF Logistics-SKX, LLC and Bank of America, N.A. as administrative agent and as lender (Bank of America or the Administrative Agent) and Raymond James Bank, FSB. The proceeds from the Loan Agreement are being used to construct our domestic distribution facility in Rancho Belago, California. Borrowings made pursuant to the Loan Agreement may be made up to a maximum limit of \$55.0 million and the loan matures on April 30, 2012, which may be extended for six months if certain conditions are met. Borrowings bear interest based on LIBOR. We had \$45.9 million outstanding under this facility, which is included in short-term borrowings on September 30, 2011. We paid commitment fees of \$737,500 on this loan, which are being amortized over the life of the facility.

On January 30, 2010, we entered into a joint venture agreement with HF Logistics I, LLC through Skechers R.B., LLC, a wholly-owned subsidiary, regarding the ownership and management of HF Logistics-SKX, LLC, a Delaware limited liability company. The purpose of the JV was to acquire and to develop real property consisting of approximately 110 acres situated in Rancho Belago, California, and to construct approximately 1.8 million square feet of buildings and other improvements to lease to us as a distribution facility. The term of the JV is fifty years. The parties are equal fifty percent partners. In April 2010, we made an initial cash capital contribution of \$30 million and HF made an initial capital contribution of land to the JV. Additional capital contributions, if necessary, would be made on an equal basis by Skechers R.B., LLC and HF. We have completed our assessment of the joint

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venture and have determined it to be a variable interest entity (VIE) and that Skechers is the primary beneficiary, and therefore consolidate the operations of the joint venture into our financial statements.

On June 30, 2009, we entered into a \$250.0 million secured credit agreement, (the Credit Agreement) with a syndicate of seven banks that replaced the previous \$150 million credit agreement. On November 5, 2009, March 4, 2010 and May 3, 2011, we entered into three successive amendments to the Credit Agreement (collectively, the Amended Credit Agreement). The Amended Credit Agreement matures in June 2015. The credit agreement permits us and certain of our subsidiaries to borrow up to \$250.0 million based upon a borrowing base of eligible accounts receivable and inventory, which amount can be increased to \$300.0 million at our request and upon satisfaction of certain conditions including obtaining the commitment of existing or prospective lenders willing to provide the incremental amount. Borrowings bear interest at our election based on LIBOR or a Base Rate (defined as the greatest of the base LIBOR plus 1.00%, the Federal Funds Rate plus 0.5% or one of the lenders prime rate), in each case, plus an applicable margin based on the average daily principal balance of revolving loans under the credit agreement (1.00%, 1.25% or 1.50% for Base Rate loans and 2.00%, 2.25% or 2.50% for LIBOR loans). We pay a monthly unused line of credit fee of 0.375% or 0.5% per annum, which varies based on the average daily principal balance of outstanding revolving loans and undrawn amounts of letters of credit outstanding during such month. The Amended Credit Agreement further provides for a limit on the issuance of letters of credit to a maximum of \$50.0 million. The Amended Credit Agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including a fixed charge coverage ratio that applies when excess availability is less than \$40.0 million. In addition, the Amended Credit Agreement places limits on additional indebtedness that we are permitted to incur as well as other restrictions on certain transactions. We paid syndication and commitment fees of \$6.7 million on this facility, which are being amortized over the remaining four-year life of the facility.

We had outstanding short-term and long-term borrowings of \$138.3 million as of September 30, 2011, of which \$70.7 million relates to notes payable for warehouse equipment for our new distribution center which are secured by the equipment, \$45.9 million relates to our construction loan for our new distribution center, \$18.2 million relates to a note for development costs paid by and due to HF for our new distribution center, and the remaining balance relates to our joint venture in China.

We believe that anticipated cash flows from operations, available borrowings under our secured line of credit, existing cash balances and current financing arrangements will be sufficient to provide us with the liquidity necessary to fund our anticipated working capital and capital requirements through September 30, 2012. However, in connection with our current strategies, we will incur significant working capital requirements and capital expenditures. Our future capital requirements will depend on many factors, including, but not limited to, the global recession and the pace of recovery in our markets, costs associated with moving to a new distribution facility, the levels at which we maintain inventory, sale of excess inventory at discounted prices, the market acceptance of our footwear, the success of our international operations, the levels of advertising and marketing required to promote our footwear, the extent to which we invest in new product design and improvements to our existing product design, any potential acquisitions of other brands or companies, and the number and timing of new store openings. To the extent that available funds are insufficient to fund our future activities, we may need to raise additional funds through public or private financing of debt or equity. Recently, we have been successful in raising additional funds through financing activities however, we cannot be assured that additional financing will be available to us or that, if available, it can be obtained on past terms which have been favorable to our stockholders and us. Failure to obtain such financing could delay or prevent our current business plans, which could adversely affect our business, financial condition and results of operations. In addition, if additional capital is raised through the sale of additional equity or convertible securities, dilution to our stockholders could occur.

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OFF-BALANCE SHEET ARRANGEMENTS

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. For a detailed discussion of the our critical accounting policies, please refer to our annual report on Form 10-K for the year ended December 31, 2010 filed with the U.S. Securities and Exchange Commission (SEC) on March 1, 2011. Our critical accounting policies and estimates did not change materially during the quarter ended September 30, 2011.

QUARTERLY RESULTS AND SEASONALITY

While sales of footwear products have historically been seasonal in nature with the strongest sales generally occurring in the second and third quarters, we believe that changes in our product offerings have somewhat mitigated the effect of this seasonality.

We have experienced, and expect to continue to experience, variability in our net sales and operating results on a quarterly basis. Our domestic customers generally assume responsibility for scheduling pickup and delivery of purchased products. Any delay in scheduling or pickup which is beyond our control could materially negatively impact our net sales and results of operations for any given quarter. We believe the factors which influence this variability include (i) the timing of our introduction of new footwear products, (ii) the level of consumer acceptance of new and existing products, (iii) general economic and industry conditions that affect consumer spending and retail purchasing, (iv) the timing of the placement, cancellation or pickup of customer orders, (v) increases in the number of employees and overhead to support growth, (vi) the timing of expenditures in anticipation of increased sales and customer delivery requirements, (vii) the number and timing of our new retail store openings and (viii) actions by competitors. Because of these and other factors, the operating results for any particular quarter are not necessarily indicative of the results for the full year.

INFLATION

We do not believe that the rates of inflation experienced in the United States over the last three years have had a significant effect on our sales or profitability. However, we cannot accurately predict the effect of inflation on future operating results. Although higher rates of inflation have been experienced in a number of foreign countries in which our products are manufactured, we do not believe that inflation has had a material effect on our sales or profitability. While we have been able to offset our foreign product cost increases by increasing prices or changing suppliers in the past, we cannot assure you that we will be able to continue to make such increases or changes in the future.

EXCHANGE RATES

Although we currently invoice most of our customers in U.S. dollars, changes in the value of the U.S. dollar versus the local currency in which our products are sold, along with economic and political conditions of such foreign countries, could adversely affect our business, financial condition and results of operations. Purchase prices

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for our products may be impacted by fluctuations in the exchange rate between the U.S. dollar and the local currencies of the contract manufacturers, which may have the effect of increasing our cost of goods in the future. In addition, the weakening of an international customer's local currency and banking market may negatively impact such customer's ability to meet their payment obligations to us. We regularly monitor the creditworthiness of our international customers and make credit decisions based on both prior sales experience with such customers and their current financial performance, as well as overall economic conditions. While we currently believe that our international customers have the ability to meet all of their obligations to us, there can be no assurance that they will continue to be able to meet such obligations. During 2010 and the first nine months of 2011, exchange rate fluctuations did not have a material impact on our inventory costs. We do not engage in hedging activities with respect to such exchange rate risk.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not hold any derivative securities that require fair value presentation per ASC 815-25.

Market risk is the potential loss arising from the adverse changes in market rates and prices, such as interest rates and foreign currency exchange rates. Changes in interest rates and changes in foreign currency exchange rates have and will have an impact on our results of operations.

Interest rate fluctuations. The interest rate charged on our secured line of credit facility is based on the prime rate of interest, and changes in the prime rate of interest will have an effect on the interest charged on outstanding balances. No amounts relating to this secured line of credit facility are currently outstanding at September 30, 2011. We had \$49.4 million of outstanding short-term borrowings subject to changes in interest rates; however, we do not expect any changes will have a material impact on our financial condition or results of operations.

Foreign exchange rate fluctuations. We face market risk to the extent that changes in foreign currency exchange rates affect our non-U.S. dollar functional currency foreign subsidiaries' revenues, expenses, assets and liabilities. In addition, changes in foreign exchange rates may affect the value of our inventory commitments. Also, inventory purchases of our products may be impacted by fluctuations in the exchange rates between the U.S. dollar and the local currencies of the contract manufacturers, which could have the effect of increasing the cost of goods sold in the future. We manage these risks by primarily denominating these purchases and commitments in U.S. dollars. We do not engage in hedging activities with respect to such exchange rate risks.

Assets and liabilities outside the United States are located in the United Kingdom, France, Germany, Spain, Portugal, Switzerland, Italy, Canada, Belgium, the Netherlands, Brazil, Chile, China, Hong Kong, Singapore, Malaysia, Thailand, Vietnam, and Japan. Our investments in foreign subsidiaries with a functional currency other than the U.S. dollar are generally considered long-term. Accordingly, we do not hedge these net investments. The fluctuation of foreign currencies resulted in a cumulative foreign currency translation loss of \$6.6 million and less than \$0.1 million for the nine months ended September 30, 2011 and 2010, respectively, that are deferred and recorded as a component of accumulated other comprehensive income in stockholders' equity. A 200 basis point reduction in each of these exchange rates at September 30, 2011 would have reduced the values of our net investments by approximately \$6.5 million.

ITEM 4. CONTROLS AND PROCEDURES

Attached as exhibits to this quarterly report on Form 10-Q are certifications of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (the Exchange Act). This Controls and Procedures section includes information concerning the controls and controls evaluation referred to in the certifications.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and

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reported within required time periods and that such information is accumulated and communicated to the officers who certify our financial reports as well as other members of senior management to allow timely decisions regarding required disclosures. As of the end of the period covered by this quarterly report on Form 10-Q, we carried out an evaluation under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of such period.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting during the three months ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

INHERENT LIMITATIONS ON EFFECTIVENESS OF CONTROLS

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements as a result of error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls' effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements as a result of error or fraud may occur and not be detected.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Our claims and advertising for our toning products including for our Shape-ups are subject to the requirements of, and routinely come under review by regulators including the U.S. Federal Trade Commission (FTC), states' Attorneys General and government and quasi-government regulators in foreign countries. We are currently responding to requests for information regarding our claims and advertising from regulatory and quasi-regulatory agencies in the United States and several other countries and are fully cooperating with those requests. While we believe that our claims and advertising with respect to our core toning products are supported by scientific tests, expert opinions and other relevant data, and while we have been successful in defending our claims and advertising in several different countries, we have discontinued using certain test results and we periodically review and update our claims and advertising. The regulatory inquiries may conclude in a variety of outcomes, including the closing of the inquiry with no further regulatory action, settlement of any issues through changes in our claims and advertising, settlement of any issues through payment to the regulatory entity, or litigation.

Based on discussions with the FTC staff, we do not believe that the FTC's pending inquiry into our toning products will likely end in a closure letter assuring no further regulatory action. The FTC's Director of the Bureau of Consumer Protection has referred the matter to the FTC Commissioners for consideration of whether to bring an action against us for false and deceptive advertising in connection with our toning products. We intend to defend this matter vigorously and will be meeting with each Commissioner in the fourth quarter to present evidence and

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arguments against bringing such an action. In this regard, one of our competitors, which also sells toning products, recently settled a matter with the FTC and related consumer class actions for the payment of \$25 million plus an additional \$4.6 million in attorneys' fees. While we believe that the facts relating to the FTC inquiry into our toning products and our consumer class actions are different from our competitor's, we could be subject to a comparable, or higher, exposure as a result of these proceedings. We believe it is still too early in the process to predict the final outcomes of the FTC inquiry or any other pending inquiries (or any resulting regulatory action) or the related consumer class actions, to reasonably estimate a range of potential losses for any of these matters, or to predict whether such outcomes will have a material effect on our advertising, promotional claims, business, results of operations or financial position. While it is not possible to predict the outcomes of the FTC inquiry, any other pending inquiries, or the related consumer class actions, it is possible that costs associated with these proceedings could have a material adverse impact on our consolidated earnings, financial position, or cash flows.

The toning footwear category, including our Shape-ups products, has also been the subject of some media attention arising from a number of consumer complaints and allegations of injury while wearing Shape-ups. We believe our products are safe and are defending ourselves from these media stories and injury allegations. It is too early, however, to predict the outcome of the ongoing inquiries and whether such an outcome will have a material effect on our advertising, promotional claims, business, results of operations or financial position.

Asics Corporation and Asics America Corporation v. Skechers U.S.A., Inc. On May 11, 2010, Asics Corporation and Asics America Corporation (collectively, "Asics") filed an action against our company in the United States District Court for the Central District of California, SACV 10-00636 CJC/MLG, alleging trademark infringement, unfair competition, and trademark dilution under both federal and California law and false advertising under California law arising out of our alleged use of stripe designs similar to Asics trademarks. The complaint seeks, among other things, permanent and preliminary injunctive relief, compensatory damages, profits, treble and punitive damages, and attorneys' fees. The matter is in the early discovery phase. While it is too early to predict the outcome of the litigation and whether an adverse result would have a material adverse impact on our operations or financial position, we believe we have meritorious defenses and counterclaims, vehemently deny the allegations and intend to defend the case vigorously.

Tamara Grabowski v. Skechers U.S.A., Inc. On June 18, 2010, Tamara Grabowski filed an action against our company in the United States District Court for the Southern District of California, Case No. 10 CV 1300 JM (WVG), on her behalf and on behalf of all others similarly situated. The complaint, as subsequently amended, alleges that our advertising for Shape-ups violates California's Unfair Competition Law and the California Consumer Legal Remedies Act, and constitutes a breach of express warranty (the "*Grabowski* action"). The complaint seeks certification of a nationwide class, damages, restitution and disgorgement of profits, declaratory and injunctive relief, corrective advertising, and attorneys' fees and costs. On March 7, 2011, the court stayed the action on the ground that the outcomes in pending appeals in two unrelated actions will significantly affect whether a class should be certified. While it is too early to predict the outcome of the litigation or a reasonable range of potential losses and whether an adverse result would have a material adverse impact on our results of operations or financial position, we believe we have meritorious defenses, vehemently deny the allegations, believe that class certification is not warranted and intend to defend the case vigorously.

Sonia Stalker v. Skechers U.S.A., Inc. On July 2, 2010, Sonia Stalker filed an action against our company in the Superior Court of the State of California for the County of Los Angeles, on her behalf and on behalf of all others similarly situated, alleging that our advertising for Shape-ups violates California's Unfair Competition Law and the California Consumer Legal Remedies Act. The complaint, as subsequently amended, seeks certification of a nationwide class, actual and punitive damages, restitution, declaratory and injunctive relief, corrective advertising, and attorneys' fees and costs. On July 23, 2010, we removed the case to the United States District Court for the Central District of California, and it is now pending as *Sonia Stalker v. Skechers USA, Inc.*, CV 10-5460 SJO (JEM). On August 23, 2010, we filed a motion to dismiss the action or transfer it to the United States District Court for the Southern District of California, in view of the prior pending *Grabowski* action. On August 27, 2010, plaintiff moved to certify the class, which motion we have opposed. On January 21, 2011, the court stayed the action for the separate reasons that the *Grabowski* action was filed first and takes priority under the first-to-file doctrine and that the outcomes in pending appeals in two unrelated actions will significantly affect the outcome of plaintiff's motion for class certification and the resolution of this action. While it is too early to predict the outcome of the litigation or a

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reasonable range of potential losses and whether an adverse result would have a material adverse impact on our results of operations or financial position, we believe we have meritorious defenses, vehemently deny the allegations, believe that class certification is not warranted and intend to defend the case vigorously.

Venus Morga v. Skechers U.S.A., Inc. On August 25, 2010, Venus Morga filed an action against our company in the United States District Court for the Southern District of California, Case No. 10 CV 1780 JM (WVG), on her behalf and on behalf of all others similarly situated. The complaint, as subsequently amended, alleges that our advertising for Shape-ups violates California's Unfair Competition Law and the California Consumer Legal Remedies Act, and constitutes a breach of express warranty. The complaint seeks certification of a nationwide class, damages, restitution and disgorgement of profits, declaratory and injunctive relief, corrective advertising, and attorneys' fees and costs. On March 7, 2011, the court stayed the action on the ground that the outcomes in pending appeals in two unrelated actions will significantly affect whether a class should be certified. While it is too early to predict the outcome of the litigation or a reasonable range of potential losses and whether an adverse result would have a material adverse impact on our results of operations or financial position, we believe we have meritorious defenses, vehemently deny the allegations, believe that class certification is not warranted and intend to defend the case vigorously.

Tamia Richmond v. Skechers U.S.A., Inc. and HKM Productions, Inc. On August 31, 2010, Tamia Richmond filed a lawsuit against our company and HKM Productions in California Superior Court, County of Los Angeles, Case No. BC444730. The complaint alleged, among other things, that we had used Ms. Richmond's image and likeness in certain unauthorized forms of media. We subsequently settled the matter and, on July 13, 2011, Ms. Richmond filed a dismissal with prejudice with the court. The settlement did not have a material adverse impact on our results of operations or financial position.

Charles Davis, Angela Meng, Paisley McCollum, Daniel Liu, Chanel Celaya, Kathy Gardiner, Samantha Rex, Tracy Long Stover, Talesha Byrd, Sean Myrie, and Marielle Jaffe v. Skechers U.S.A., Inc. and Skechers U.S.A., Inc. II On August 12, 2011, Charles Davis, Angela Meng, Paisley McCollum, Daniel Liu, Chanel Celaya, Kathy Gardiner, Samantha Rex, Tracy Long Stover, Talesha Byrd, Sean Myrie, and Marielle Jaffe (collectively, the Plaintiffs) filed a lawsuit against our company in the Superior Court of the State of California for the County of Los Angeles, Case No. SC113783. The complaint alleges, among other things, that we have intentionally and knowingly misappropriated Plaintiffs' common law and statutory law rights of publicity by using their images and likenesses in certain unauthorized forms of media. Plaintiffs are seeking compensatory, punitive and exemplary damages, injunctive relief, interest, attorneys' fees and costs. While it is too early to predict the outcome of the litigation and whether an adverse result would have a material adverse impact on our operations or financial position, we believe we have meritorious defenses, vehemently deny the allegations and intend to defend the case vigorously.

Patty Tomlinson v. Skechers U.S.A., Inc. On January 13, 2011, Patty Tomlinson filed a lawsuit against our company in Circuit Court in Washington County, Arkansas, Case No. CV11-121-7. The complaint alleges, on her behalf and on behalf of all others similarly situated, that our advertising for Shape-ups violates Arkansas' Deceptive Trade Practices Act, constitutes a breach of certain express and implied warranties, and is resulting in unjust enrichment (the Tomlinson action). The complaint seeks certification of a statewide class, compensatory damages, prejudgment interest, and attorneys' fees and costs. On February 18, 2011, we removed the case to the United States District Court for the Western District of Arkansas, and it is now pending as *Patty Tomlinson v. Skechers U.S.A., Inc.*, CV 11-05042 JLH. On March 16, 2011, we filed a motion to dismiss the action or transfer it to the United States District Court for the Southern District of California, in view of the prior pending *Grabowski* action. On March 21, 2011, Ms. Tomlinson moved to remand the action back to Arkansas state court, which motion we opposed. On May 25, 2011, the court ordered the case remanded to Arkansas state court and denied our motion to dismiss or transfer as moot, but has stayed remand pending completion of appellate review. On September 2, 2011, we filed a petition in the United States Supreme Court seeking a writ of *certiorari* relating to the propriety of remand, and on November 7, 2011, the Supreme Court denied our petition. While it is too early to predict the outcome of the litigation or a reasonable range of potential losses and whether an adverse result would have a material adverse impact on our results of operations or financial position, we believe we have meritorious defenses, vehemently deny the allegations, believe that class certification is not warranted and intend to defend the case vigorously.

Terena Lovston v. Skechers U.S.A., Inc. On May 13, 2011, Terena Lovston filed a lawsuit against

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our company in Circuit Court in Lonoke County, Arkansas, Case No. CV-11-321. The complaint alleges, on her behalf and on behalf of all others similarly situated, that our advertising for our toning footwear products violates Arkansas Deceptive Trade Practices Act, and is resulting in unjust enrichment. The complaint seeks certification of a statewide class and compensatory damages. On June 3, 2011, we removed the case to the United States District Court for the Eastern District of Arkansas, and it is now pending as *Terena Lovston v. Skechers U.S.A., Inc.*, 4:11-cv-00460-DPM. On June 6, 2011, we filed a motion to dismiss the action or transfer it to the United States District Court for the Southern District of California, in view of the prior pending *Grabowski* action. On July 19, 2011, the court indicated its intent to remand the case to Arkansas state court but stayed remand pending further briefing by the parties. On August 5, 2011, the court issued an order staying the case pending completion of the appellate process in the *Tomlinson* action. On November 7, 2011, the United States Supreme Court denied our petition for a writ of certiorari in the *Tomlinson* action. While it is too early to predict the outcome of the litigation or a reasonable range of potential losses and whether an adverse result would have a material adverse impact on our results of operations or financial position, we believe we have meritorious defenses, vehemently deny the allegations, believe that class certification is not warranted and intend to defend the case vigorously.

Skechers U.S.A., Inc. and Skechers U.S.A., Inc. II v. Elon A. Pollack, Elon A. Pollack, a Professional Corporation dba Law Offices of Elon A. Pollock, and Stein, Shostak, Shostak, Pollack & O Hara, LLP On March 3, 2011, we filed a complaint against Elon A. Pollack, Elon A. Pollack, a Professional Corporation dba Law Offices of Elon A. Pollock, and Stein, Shostak, Shostak, Pollack & O Hara, LLP (collectively, the Defendants) in Superior Court of the State of California in Los Angeles County, Case No. YC064333. In our complaint, we alleged, among other things, that the Defendants had breached their duties of care, loyalty and fidelity to us by negligently and carelessly providing legal representation, and that the Defendants had engaged in self-dealing and breaches of their fiduciary duties to us. We are seeking actual and consequential damages, declaratory relief, interest, punitive damages, and attorneys' fees and costs. On August 3, 2011, the Defendants filed a first amended cross complaint against us, which alleges breach of written contract for failure to pay certain contingency fees, entitlement to contingency fees based on the principal of quantum meruit, breach of implied covenant of good faith and fair dealing, and fraud and intentional misrepresentation. The Defendants seek damages under the retainer agreement, the reasonable value of their services, as well as consequential and incidental damages, interest, punitive damages, and costs. While it is too early to predict the outcome of the litigation and whether an adverse result would have a material adverse impact on our operations or financial position, we believe we have meritorious defenses and counterclaims, vehemently deny the allegations and intend to defend the case vigorously.

Skechers U.S.A., Inc. and Skechers U.S.A., Inc. II v. Larrie Corporation (M) Sdn Bhd On March 17, 2011, we filed a complaint against Larrie Corporation (M) Sdn Bhd (Larrie) in the High Court of Malaya at Kuala Lumpur (Commercial Division), Case No. D-22IP-12-2011. In our complaint, we alleged that Larrie passed off footwear bearing marks that resemble our trademarks, and unlawfully interfered with our trade in Malaysia. On May 4, 2011, Larrie filed a defense and counterclaim against us, which alleged that Larrie was entitled to the exclusive right to use an S logo in Malaysia in connection with footwear, that we had unlawfully interfered with Larrie's business, and that we had maliciously commenced the lawsuit and made false and malicious allegations. We subsequently settled the matter and the litigation has now been discontinued. The settlement will not have a material adverse impact on our results of operations or financial position.

Personal Injury Lawsuits Involving Shape-ups. As previously reported, on February 20, 2011, Skechers U.S.A., Inc., Skechers U.S.A., Inc. II and Skechers Fitness Group were named as defendants in a lawsuit that alleged, among other things, that Shape-ups are defective and unreasonably dangerous, negligently designed and/or manufactured, and do not conform to representations made by us, and that we failed to provide adequate warnings of alleged risks associated with Shape-ups. Also, as previously reported, through August 9, 2011, four additional cases were filed in state and federal courts against these defendants, claiming a variety of alleged injuries, but asserting legal theories similar to those in the first case and adding claims for breach of express and implied warranties, loss of consortium, and fraud. Since then, our company has been named in an additional 16 cases that assert further varying injuries but employ similar legal theories and assert similar claims to the first five cases. In each of the following cases, except as noted below, the plaintiffs seek compensatory and/or economic damages, exemplary and/or punitive damages, and attorneys' fees and costs.

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| Case Name | Case Number | Court |
|---|--------------------|--|
| Holly and Timothy Ward v. Skechers U.S.A., Inc., Skechers U.S.A., Inc. II and Skechers Fitness Group | 1:11-cv-00080-MPB | United States District Court, Southern District of Ohio |
| (No exemplary or punitive damages sought) | | |
| Allison Drury v. Skechers U.S.A., Inc., Skechers U.S.A., Inc. II and Skechers Fitness Group | 3:11-cv-00201-CRS | United States District Court, Western District of Kentucky, Louisville Division |
| Nellie Barker v. Skechers U.S.A., Inc. and J.C. Penney Company, Inc. | 30-2011-00469782 | Superior Court of the State of California in Orange County |
| Melissa and Richard Kearnely v. Skechers U.S.A., Inc., Skechers U.S.A., Inc. II and Skechers Fitness Group | | |