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MOVADO GROUP INC  
Form 10-Q  
September 07, 2006

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
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FORM 10-Q  
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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended July 31, 2006

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-16497

MOVADO GROUP, INC.

(Exact Name of Registrant as Specified in its Charter)

New York  
(State or Other Jurisdiction  
of Incorporation or Organization)

13-2595932  
(IRS Employer  
Identification No.)

650 From Road, Paramus, New Jersey  
(Address of Principal Executive Offices)

07652  
(Zip Code)

(201) 267-8000  
(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 that past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer" or "large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer  Accelerated filer  Non-accelerated filer

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 outstanding of the registrant's common stock and class A common stock as of August 31, 2006 were 19,036,033 and 6,657,159, respectively.  
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MOVADO GROUP, INC.

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July 31, 2006

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PART I - FINANCIAL INFORMATION  
Item 1. Financial Statements

MOVADO GROUP, INC.  
CONSOLIDATED BALANCE SHEETS  
(In thousands, except share and per share amounts)  
(Unaudited)

July 31, 2006	January 31, 2006	July 31, 2005
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ASSETS			
Current assets:			
Cash and cash equivalents	\$ 78,126	\$123,625	\$ 50,323
Trade receivables, net	128,416	109,852	108,775
Inventories	215,461	198,582	203,047
Other assets	34,712	26,596	33,392
	-----	-----	-----
Total current assets	456,715	458,655	395,537
Property, plant and equipment, net	51,931	52,168	52,687
Other assets	40,464	39,069	38,519
	-----	-----	-----
Total assets	\$549,110	\$549,892	\$486,743
	=====	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Loans payable to banks	\$ --	\$ --	\$ 37,500
Current portion of long-term debt	5,000	5,000	--
Accounts payable	40,266	35,529	35,283
Accrued liabilities	31,990	43,065	41,129
Current taxes payable	1,674	7,724	--
Deferred taxes	876	503	4,756
	-----	-----	-----
Total current liabilities	79,806	91,821	118,668
Long-term debt	91,978	104,955	45,000
Deferred and non-current income taxes	13,278	11,947	9,031
Other liabilities	20,112	19,491	17,363
	-----	-----	-----
Total liabilities	205,174	228,214	190,062
	-----	-----	-----
Commitments and contingencies (Note 8)			
Minority interest	245	--	--
Shareholders' equity:			
Preferred Stock, \$0.01 par value, 5,000,000 shares authorized; no shares issued	--	--	--
Common Stock, \$0.01 par value, 100,000,000 shares authorized; 23,661,968, 23,215,836 and 23,116,663 shares issued, respectively	237	232	231
Class A Common Stock, \$0.01 par value, 30,000,000 shares authorized; 6,700,909, 6,766,909 and 6,773,258 shares issued and outstanding, respectively	67	68	68
Capital in excess of par value	113,405	107,965	103,470
Retained earnings	247,656	236,515	221,981
Accumulated other comprehensive income	34,812	27,673	21,997
Treasury Stock, 4,676,117, 4,613,645 and 4,613,645 shares, respectively, at cost	(52,486)	(50,775)	(51,066)
	-----	-----	-----
Total shareholders' equity	343,691	321,678	296,681
	-----	-----	-----
Total liabilities and equity	\$549,110	\$549,892	\$486,743
	=====	=====	=====

See Notes to Consolidated Financial Statements

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MOVADO GROUP, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
(In thousands, except per share amounts)  
(Unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2006	2005	2006	2005
Net sales	\$126,588	\$115,326	\$224,332	\$203,082
Cost of sales	48,076	45,340	86,230	80,258
Gross profit	78,512	69,986	138,102	122,824
Selling, general and administrative	64,438	57,701	120,594	108,400
Operating income	14,074	12,285	17,508	14,424
Interest expense	(919)	(926)	(1,862)	(1,804)
Interest income	616	42	1,507	111
Minority interest	(15)	--	64	--
Income before income taxes	13,756	11,401	17,217	12,731
Provision for income taxes	2,407	2,850	3,013	3,183
Net income	\$ 11,349	\$ 8,551	\$ 14,204	\$ 9,548
Earnings per share:				
Basic	\$ 0.44	\$ 0.34	\$ 0.56	\$ 0.38
Diluted	\$ 0.43	\$ 0.33	\$ 0.54	\$ 0.37
Weighted-average shares outstanding:				
Basic	25,661	25,241	25,550	25,148
Diluted	26,584	26,126	26,506	26,074

See Notes to Consolidated Financial Statements

MOVADO GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)  
(Unaudited)

Six Months  
Ended July 31,

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	2006	2005
	-----	-----
Cash flows from operating activities:		
Net income	\$ 14,204	\$ 9,548
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	7,736	7,816
Deferred income taxes	(1,351)	(731)
Provision for losses on accounts receivable	1,739	600
Provision for losses on inventory	319	300
Stock-based compensation	1,340	624
Excess tax benefit from stock-based compensation	(1,345)	--
Minority interest	(64)	--
Changes in assets and liabilities:		
Trade receivables	(17,858)	(3,813)
Inventories	(13,146)	(27,078)
Other current assets	(5,575)	(4,312)
Accounts payable	4,059	(1,526)
Accrued liabilities	(8,893)	(6,363)
Current taxes payable	(4,704)	159
Other non-current assets	(1,448)	(912)
Other non-current liabilities	616	174
	-----	-----
Net cash used in operating activities	(24,371)	(25,514)
	-----	-----
Cash flows from investing activities:		
Capital expenditures	(6,811)	(7,879)
Trademarks	(381)	(343)
	-----	-----
Net cash used in investing activities	(7,192)	(8,222)
	-----	-----
Cash flows from financing activities:		
Net (repayments) / proceeds of bank borrowings	(15,161)	37,500
Stock options exercised and other changes	1,048	(819)
Excess tax benefit from stock-based compensation	1,345	--
Dividends paid	(3,063)	(2,520)
	-----	-----
Net cash (used in) / provided by financing activities	(15,831)	34,161
	-----	-----
Effect of exchange rate changes on cash and cash equivalents	1,895	(13,884)
	-----	-----
Net decrease in cash and cash equivalents	(45,499)	(13,459)
	-----	-----
Cash and cash equivalents at beginning of period	123,625	63,782
	-----	-----
Cash and cash equivalents at end of period	\$ 78,126	\$ 50,323
	=====	=====

See Notes to Consolidated Financial Statements

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The accompanying unaudited consolidated financial statements have been prepared by Movado Group, Inc. (the "Company") in a manner consistent with that used in the preparation of the consolidated financial statements included in the Company's fiscal 2006 Annual Report filed on Form 10-K. In the opinion of management, the accompanying consolidated financial statements reflect all adjustments, consisting of only normal and recurring adjustments, necessary for a fair statement of the financial position and results of operations for the periods presented. These consolidated financial statements should be read in conjunction with the aforementioned Annual Report. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for the full year.

### NOTE 1 - RECLASSIFICATION

Certain reclassifications were made to prior years' financial statement amounts and related note disclosures to conform to the fiscal 2007 presentation.

### NOTE 2 - STOCK-BASED COMPENSATION

Effective concurrently with the consummation of the Company's public offering in the fourth quarter of fiscal 1994, the Board of Directors and the shareholders of the Company approved the adoption of the Movado Group, Inc. 1993 Employee Stock Option Plan (the "Employee Stock Option Plan") for the benefit of certain officers, directors and key employees of the Company. The Employee Stock Option Plan was amended in fiscal 1997 and restated as the Movado Group, Inc. 1996 Stock Incentive Plan (the "Plan"). Under the Plan, as amended and restated as of April 8, 2004, the Compensation Committee of the Board of Directors, which is comprised of four of the Company's outside directors, has the authority to grant incentive stock options and nonqualified stock options to purchase, as well as stock appreciation rights and stock awards, up to 9,000,000 shares of Common Stock. Options granted to participants under the Plan generally become exercisable in equal installments over three or five years and remain exercisable until the tenth anniversary of the date of grant. The option price may not be less than the fair market value of the stock at the time the options are granted.

On February 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("SFAS No. 123(R)"), electing to use the modified prospective application transition method, and accordingly, prior period financial statements have not been restated. Under this method, the fair value of all stock options granted after adoption and the unvested portion of previously granted awards must be recognized in the Consolidated Statements of Income. The Company utilizes the Black-Scholes option-pricing model to calculate the fair value of each option at the grant date which requires certain assumptions be made. The expected life of stock option grants is determined using historical data and represents the time period which the stock option is expected to be outstanding until it is exercised. The risk free interest rate is the yield on the grant date of U.S. Treasury constant maturities with a maturity date closest to the expected life of the stock option. The expected stock price volatility is derived from historical volatility and calculated based on the estimated term structure of the stock option grant. The expected dividend yield is calculated using the expected annualized dividend which remains constant during the expected term of the option.

The weighted-average assumptions used with the Black-Scholes option-pricing model for the calculation of the fair value of stock option grants during the six months ended July 31, 2006 were: expected term of 5.59 years;

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risk-free interest rate of 5.01%; expected volatility of 31.78% and dividend yield of 1.29%. The weighted-average grant date fair value of options granted during the six months ended July 31, 2006 was \$6.34.

Total compensation expense for unvested stock option grants recognized during the three and six months ended July 31, 2006 was approximately \$0.2 million, net of a tax benefit of \$0.1 million and \$0.4 million, net of a tax benefit of \$0.2 million, respectively. Expense related to stock option compensation is recognized on a straight-line basis over the vesting term. As of July 31, 2006, there was approximately \$3.0 million of unrecognized compensation cost related to unvested stock options. These costs are expected to be recognized over a weighted-average period of 2.5 years. Total cash received for stock option exercises during the six months ended July 31, 2006 amounted to approximately \$2.4 million. Windfall tax benefits realized on these exercises were approximately \$1.0 million.

Prior to February 1, 2006, employee stock options were accounted for under the intrinsic value method, which measures compensation cost as the excess, if any, of the quoted market price of the stock at grant date over the amount an employee must pay to acquire the stock. Accordingly, compensation expense had not been recognized for stock options granted at or above fair value. Had compensation expense been determined and recorded based upon the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", net income (in thousands) and net income per share would have been reduced to pro forma amounts for the three months and six months ended July 31, 2005 as follows:

(In thousands, except per share data)	Three Months Ended July 31, 2005 -----	Six Months Ended July 31, 2005 -----
Net income as reported	\$8,551	\$ 9,548
Fair value based compensation expense, net of taxes	(673)	(1,511)
	-----	-----
Pro forma net income	\$7,878	\$ 8,037
	=====	=====
Basic earnings per share:		
As reported	\$ 0.34	\$ 0.38
Pro forma under SFAS No. 123	\$ 0.31	\$ 0.32
Diluted earnings per share:		
As reported	\$ 0.33	\$ 0.37
Pro forma under SFAS No. 123	\$ 0.30	\$ 0.31

The weighted-average assumptions used with the Black-Scholes option-pricing model for the calculation of the fair value of stock option grants during the six months ended July 31, 2005 were: expected term of 7.0 years; risk-free interest rate of 3.76%; expected volatility of 46.52% and dividend yield of 1.75%. The weighted-average grant date fair value of options granted during the six months ended July 31, 2005 was \$8.16.

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Stock option activity for the six months ended July 31, 2006 is summarized as follows:

	Number of Options	Weighted- Average Exercise Price
	-----	-----
January 31, 2006	3,169,613	\$12.96
Options granted	21,000	\$19.33
Options exercised	(42,564)	\$ 8.96
	-----	-----
April 30, 2006	3,148,049	\$13.06
Options granted	97,000	\$18.41
Options exercised	(242,015)	\$ 8.33
Options cancelled	(20,000)	\$14.32
	-----	-----
July 31, 2006	2,983,034	\$13.61
	=====	=====

The total intrinsic value of stock options exercised for the six months ended July 31, 2006 and 2005 was approximately \$4.0 million and \$6.2 million, respectively. The total fair value of the stock options vested for the six months ended July 31, 2006 and 2005 was approximately \$1.9 million and \$10.3 million, respectively.

The following table summarizes outstanding and exercisable stock options as of July 31, 2006:

Range of Exercise Prices	Number Outstanding	Weighted- Average Remaining Contractual Life (years)	Weighted- Average Exercise Price	Number Exercisable	Weighted- Average Exercise Price
-----	-----	-----	-----	-----	-----
\$ 3.12 - \$ 6.22	135,060	3.2	\$ 4.25	135,060	\$ 4.25
\$ 6.23 - \$ 9.34	156,198	4.1	\$ 7.26	156,198	\$ 7.26
\$ 9.35 - \$12.45	754,564	3.2	\$10.67	730,464	\$10.70
\$12.46 - \$15.57	1,198,465	5.0	\$14.53	908,365	\$14.65
\$15.58 - \$18.68	720,747	7.0	\$18.13	376,416	\$18.36
\$18.69 - \$21.81	18,000	9.1	\$19.76	334	\$18.75
	-----	---	-----	-----	-----
	2,983,034	5.0	\$13.61	2,306,837	\$12.90
	-----	---	-----	-----	-----

The total intrinsic value of outstanding and exercisable stock options as of July 31, 2006 was approximately \$26.6 million and \$22.2 million, respectively.

Under the 1996 Stock Incentive Plan, the Company has the ability to grant restricted stock to certain employees. Restricted stock grants generally vest three to five years from the date of grant. Expense for these grants is recognized on a straight-line basis over the vesting period. The fair value of restricted stock grants is equal to the closing price of the Company's publicly-traded common stock on the grant date.



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On May 31, 2006, the Compensation Committee of the Board of Directors adopted the Executive Long Term Incentive Plan (the "LTIP") authorized by section 9 of the Plan. The LTIP provides for the award of "Performance Share Units" that are equivalent, one for one, to shares of the Company's common stock and that vest based on the Company's achievement of its operating margin goal for the fiscal year ending January 31,

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2009. The number of actual shares earned by a participant is based on the Company's actual performance at the end of the award period and can range from 0% to 150% of the participant's target award. Total target awards of 189,500 Performance Share Units were granted by the Compensation Committee on May 31, 2006 that vest over three and five year periods.

Total compensation expense for restricted stock grants and for grants of Performance Share Units under the LTIP (together "restricted stock") recognized during the three months ended July 31, 2006 and 2005 was \$0.3 million, net of a tax benefit of \$0.2 million, and \$0.2 million, net of a tax benefit of \$0.1 million, respectively. Total compensation expense for restricted stock grants recognized during the six months ended July 31, 2006 and 2005 was \$0.4 million, net of a tax benefit of \$0.3 million, and \$0.4 million, net of a tax benefit of \$0.2 million, respectively. Prior to February 1, 2006, compensation expense for restricted stock grants was reduced as actual forfeitures of the awards occurred. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant in order to estimate the amount of share-based awards that will ultimately vest and thus, current period compensation expense has been adjusted for estimated forfeitures based on historical data. As of July 31, 2006, there was approximately \$4.9 million of unrecognized compensation cost related to unvested restricted stock, including those issued under the LTIP. These costs are expected to be recognized over a weighted-average period of 3.0 years.

Restricted stock activity for the six months ended July 31, 2006 are summarized as follows:

	Number of Restricted Stock Units	Weighted- Average Grant Date Fair Value
	-----	-----
January 31, 2006	321,090	\$14.39
Units granted	46,400	\$20.43
Units vested	(92,390)	\$ 9.83
Units forfeited	(220)	\$13.27
	-----	-----
April 30, 2006	274,880	\$16.95
Units granted	194,000	\$18.20
Units vested	(4,550)	\$ 9.98
Units forfeited	(8,410)	\$16.64
	-----	-----
July 31, 2006	455,920	\$17.56
	=====	=====

Restricted stock units are exercised simultaneously when they vest and are

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issued from the pool of authorized shares. The total intrinsic value of restricted stock units that vested during the six months ended July 31, 2006 was approximately \$1.9 million. The windfall tax benefits realized on the vested restricted stock grants for the six months ended July 31, 2006 were \$0.3 million. The weighted-average grant date fair values for restricted stock grants for the six months ended July 31, 2006 and 2005 were \$18.63 and \$17.89, respectively. Outstanding restricted stock units had a total intrinsic value of approximately \$10.3 million as of July 31, 2006.

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### NOTE 3 - COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss) for the three months and six months ended July 31, 2006 and 2005 are as follows (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2006	2005	2006	2005
Net income	\$11,349	\$ 8,551	\$14,204	\$ 9,548
Net unrealized gain on investments, net of tax	13	143	20	153
Effective portion of unrealized gain (loss) on hedging contracts, net of tax	157	(4,790)	2,062	(5,127)
Foreign currency translation adjustment (1)	(100)	(19,545)	5,057	(21,736)
Total comprehensive income (loss)	\$11,419	(\$15,641)	\$21,343	(\$17,162)

(1) The currency translation adjustments are not adjusted for income taxes as they relate to permanent investments in international subsidiaries.

### NOTE 4 - SEGMENT INFORMATION

The Company conducts its business primarily in two operating segments: Wholesale and Retail. The Company's Wholesale segment includes the designing, manufacturing and distribution of quality watches. The Retail segment includes the Movado Boutiques and outlet stores.

The Company divides its business into two major geographic segments: Domestic, which includes the results of the Company's North American, Caribbean and Tommy Hilfiger South American operations, and International, which includes the results of the Company's operations in all other parts of the world. The Company's International operations are principally conducted in Europe, the Middle East and Asia. The Company's International assets are substantially located in Switzerland.

Operating Segment Data for the Three Months Ended July 31, 2006 and 2005 (in thousands):

Net Sales	Operating Income
-----------	------------------

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	2006	2005	2006	2005
Wholesale	\$106,108	\$ 95,658	\$13,210	\$12,177
Retail	20,480	19,668	864	108
Consolidated total	\$126,588	\$115,326	\$14,074	\$12,285

Operating Segment Data for the Six Months Ended July 31, 2006 and 2005 (in thousands):

	Net Sales		Operating Income (Loss)	
	2006	2005	2006	2005
Wholesale	\$187,110	\$168,263	\$17,896	\$15,911
Retail	37,222	34,819	(388)	(1,487)
Consolidated total	\$224,332	\$203,082	\$17,508	\$14,424

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	Total Assets		
	July 31, 2006	January 31, 2006	July 31, 2005
Wholesale	\$483,625	\$484,767	\$420,266
Retail	65,485	65,125	66,477
Consolidated total	\$549,110	\$549,892	\$486,743

Geographic Segment Data for the Three Months Ended July 31, 2006 and 2005 (in thousands):

	Net Sales		Operating Income	
	2006	2005	2006	2005
Domestic	\$ 94,356	\$ 89,231	\$ 3,794	\$ 4,986
International	32,232	26,095	10,280	7,299

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Consolidated total	\$126,588	\$115,326	\$14,074	\$12,285
	=====	=====	=====	=====

Geographic Segment Data for the Six Months Ended July 31, 2006 and 2005 (in thousands):

	Net Sales		Operating Income	
	2006	2005	2006	2005
Domestic	\$166,910	\$157,306	\$ 728	\$ 3,669
International	57,422	45,776	16,780	10,755
Consolidated total	\$224,332	\$203,082	\$17,508	\$14,424
	=====	=====	=====	=====

Domestic and International net sales are net of intercompany sales of \$60.5 million and \$59.3 million for the three months ended July 31, 2006 and 2005, respectively.

Domestic and International net sales are net of intercompany sales of \$110.0 million and \$105.3 million for the six months ended July 31, 2006 and 2005, respectively.

	Total Assets		
	July 31, 2006	January 31, 2006	July 31, 2005
Domestic	\$353,226	\$391,310	\$276,343
International	195,884	158,582	210,400
Consolidated total	\$549,110	\$549,892	\$486,743
	=====	=====	=====

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	Long-Lived Assets		
	July 31, 2006	January 31, 2006	July 31, 2005
Domestic	\$37,126	\$37,903	\$38,932
International	14,805	14,265	13,755
Consolidated total	\$51,931	\$52,168	\$52,687
	=====	=====	=====

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### NOTE 5 - EXECUTIVE RETIREMENT PLAN

The Company has a number of employee benefit plans covering substantially all employees. Certain eligible executives of the Company have elected to defer a portion of their compensation on a pre-tax basis under a defined contribution, supplemental executive retirement plan (SERP) sponsored by the Company. The SERP was adopted effective June 1, 1995, and provides eligible executives with supplemental pension benefits in addition to amounts received under the Company's other retirement plans. The Company makes a matching contribution which vests over five years. For the three months ended July 31, 2006 and 2005, the Company recorded an expense related to the SERP of \$0.1 million for each period. For the six months ended July 31, 2006 and 2005, the Company recorded an expense related to the SERP of \$0.3 million for each period.

### NOTE 6 - INVENTORIES

Inventories consist of the following (in thousands):

	July 31, 2006	January 31, 2006	July 31, 2005
	-----	-----	-----
Finished goods	\$142,594	\$135,160	\$128,746
Component parts	65,392	59,325	68,251
Work-in-process	7,475	4,097	6,050
	-----	-----	-----
	\$215,461	\$198,582	\$203,047
	=====	=====	=====

### NOTE 7 - EARNINGS PER SHARE

The Company presents net income per share on a basic and diluted basis. Basic earnings per share is computed using weighted-average shares outstanding during the period. Diluted earnings per share is computed using the weighted-average number of shares outstanding adjusted for dilutive common stock equivalents.

The weighted-average number of shares outstanding for basic earnings per share were 25,661,000 and 25,241,000 for the three months ended July 31, 2006 and 2005, respectively. For diluted earnings per share, these amounts were increased by 923,000 and 885,000 for the three months ended July 31, 2006 and 2005, respectively, due to potentially dilutive common stock equivalents issuable under the Company's stock option plan and restricted stock grants.

The weighted-average number of shares outstanding for basic earnings per share were 25,550,000 and 25,148,000 for the six months ended July 31, 2006 and 2005, respectively. For diluted earnings per share, these amounts were increased by 956,000 and 926,000 for the six months ended July 31, 2006 and 2005, respectively, due to potentially dilutive common stock equivalents issuable under the Company's stock option plan and restricted stock grants.

### NOTE 8 - COMMITMENTS AND CONTINGENCIES

At July 31, 2006, the Company had outstanding letters of credit totaling \$1.2 million with expiration dates through August 31, 2007. One bank in the domestic

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bank group has issued irrevocable standby letters of credit for retail and operating facility leases to various landlords, for the administration of the Movado Boutique private-label credit card and Canadian payroll to the Royal Bank of Canada.

As of July 31, 2006, two European banks have guaranteed obligations to third parties on behalf of two of the Company's foreign subsidiaries in the amount of \$3.3 million in various foreign currencies.

The Company is involved from time to time in legal claims involving trademarks and intellectual property, contracts, employee relations and other matters incidental to the Company's business. Although the outcome of such matters cannot be determined with certainty, the Company's general counsel and management believe that the final outcome would not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

### NOTE 9 - RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109)" which is effective for fiscal years beginning after December 15, 2006. This interpretation clarifies the accounting for uncertainty in income taxes recognized in the financial statements by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is currently evaluating the impact of this interpretation.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### FORWARD-LOOKING STATEMENTS

Statements in this quarterly report on Form 10-Q, including, without limitation, statements under this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report, as well as statements in future filings by the Company with the Securities and Exchange Commission ("SEC"), in the Company's press releases and oral statements made by or with the approval of an authorized executive officer of the Company, which are not historical in nature, are intended to be, and are hereby identified as, "forward-looking statements" for purposes of the safe harbor provided by the Private Securities Litigation Reform Act of 1995. These statements are based on current expectations, estimates, forecasts and projections about the Company, its future performance, the industry in which the Company operates and management's assumptions. Words such as "expects", "anticipates", "targets", "goals", "projects", "intends", "plans", "believes", "seeks", "estimates", "may", "will", "should" and variations of such words and similar expressions are also intended to identify such forward-looking statements. The Company cautions readers that forward-looking statements include, without limitation, those relating to the Company's future business prospects, projected operating or financial results, revenues, working capital, liquidity, capital needs, plans for future operations, expectations regarding capital expenditures and operating expenses, effective tax rates, margins, interest costs, and income as well as assumptions relating to the foregoing. Forward-looking statements are subject to certain risks and uncertainties, some of which cannot be predicted or quantified. Actual results and future events could differ materially from those

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indicated in the forward-looking statements, due to several important factors herein identified, among others, and other risks and factors identified from time to time in the Company's reports filed with the SEC including, without limitation, the following: general economic and business conditions which may impact disposable income of consumers in the United States and the other significant markets where the Company's products are sold, general uncertainty related to possible terrorist attacks and the impact on consumer spending, changes in consumer preferences and popularity of particular designs, new product development and introduction, competitive products and pricing, seasonality, availability of alternative sources of supply in the case of the loss of any significant supplier, the loss of significant customers, the Company's dependence on key employees and officers, the ability to successfully integrate the operations of acquired businesses without disruption to other business activities, the continuation of licensing arrangements with third parties, the ability to secure and protect trademarks, patents and other intellectual property rights, the ability to lease new stores on suitable terms in desired markets and to complete construction on a timely basis, continued availability to the Company of financing and credit on favorable terms, business disruptions, disease, general risks associated with doing business outside the United States including, without limitation, import duties, tariffs, quotas, political and economic stability, and success of hedging strategies with respect to currency exchange rate fluctuations.

These risks and uncertainties, along with the risk factors discussed under Item 1A "Risk Factors" in the Company's Annual Report on Form 10-K, should be considered in evaluating any forward-looking statements contained in this Quarterly Report on Form 10-Q or incorporated by reference herein. All forward-looking statements speak only as of the date of this report or, in the case of any document incorporated by reference, the date of that document. All subsequent written and oral forward-looking statements attributable to the Company or any person acting on its behalf are qualified by the cautionary statements in this section. The Company undertakes no obligation to update or publicly release any revisions to forward-looking statements to reflect events, circumstances or changes in expectations after the date of this report.

### Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of

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assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. These estimates and assumptions also affect the reported amounts of revenues and expenses. Estimates by their nature are based on judgments and available information. Therefore, actual results could materially differ from those estimates under different assumptions and conditions.

Critical accounting policies are those that are most important to the portrayal of the Company's financial condition and the results of operations and require management's most difficult, subjective and complex judgments as a result of the need to make estimates about the effect of matters that are inherently uncertain. The Company's most critical accounting policies have been discussed in the Company's Annual Report on Form 10-K for the year ended January 31, 2006. In applying such policies, management must use significant estimates that are based on its informed judgment. Because of the uncertainty inherent in these estimates, actual results could differ from estimates used in applying the

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critical accounting policies. Changes in such estimates, based on more accurate future information, may affect amounts reported in future periods.

As of July 31, 2006, except as noted below, there have been no material changes to any of the critical accounting policies as disclosed in its Annual Report on Form 10-K for the fiscal year ended January 31, 2006.

On February 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("SFAS No. 123(R)"), electing to use the modified prospective application transition method, and accordingly, prior period financial statements have not been restated. Under this method, the fair value of all employee stock options granted after adoption and the unvested portion of previously granted awards must be recognized in the Consolidated Statements of Income. Prior to February 1, 2006, employee stock option grants were accounted for under the intrinsic value method, which measures compensation cost as the excess, if any, of the quoted market price of the stock at grant date over the amount an employee must pay to acquire the stock. Accordingly, compensation expense had not been recognized for employee stock options granted at or above fair value.

### Overview

The Company divides its watch business into distinct categories. The luxury category is comprised of the Ebel and Concord brands. The accessible luxury category is comprised of the Movado and ESQ brands. The licensed brands category represents all brands distributed under licensing agreements and includes Coach, Hugo Boss and Tommy Hilfiger.

Results of operations for the three months ended July 31, 2006 as compared to the three months ended July 31, 2005

Net Sales: Comparative net sales by business segment were as follows (in thousands):

	Three Months Ended July 31,	
	2006	2005
Wholesale:		
Domestic	\$ 73,876	\$ 69,563
International	32,232	26,095
Retail	20,480	19,668
Net Sales	\$126,588	\$115,326

Net sales increased by \$11.3 million or 9.8% for the three months ended July 31, 2006 as compared to the three months ended July 31, 2005.

Sales in the domestic wholesale segment were \$73.9 million for the three months ended July 31, 2006 representing a 6.2% increase above prior year sales of \$69.6 million. The increase of \$4.3 million was attributed to higher sales in the



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accessible luxury brands category. Movado sales were above prior year by \$5.0 million as the brand achieved increased demand in the major chain and department store businesses in part due to the successful launch of the Series 800 sport collection. ESQ sales were above prior year by \$1.1 million primarily due to new door openings as the brand continues to gain positive retailer response to the new model introductions as well as the ESQ&U marketing campaign. Sales of both luxury brands were down by \$3.4 million year over year. Ebel sales were \$1.7 million below prior year primarily the result of the timing of new product launches in the first quarter this fiscal year compared to the second quarter of the prior year. Concord sales decreased by \$1.7 million as planned. The Company is in the process of developing a strategic plan for the re-launch of the Concord brand. Sales of licensed brands were above the prior year period by \$1.6 million.

Sales in the international wholesale segment were \$32.2 million or 23.5% above prior year sales of \$26.1 million. In the luxury brands category, sales increased by \$1.7 million. Increased sales of \$2.9 million were recorded for Ebel primarily due to the Brasilia collection launch, while Concord sales decreased by \$1.2 million for the same reasons as in the domestic wholesale segment. In the accessible luxury brands category, Movado sales were below prior year by \$1.1 million due to planned reductions in the brand's overseas distribution. In the licensed brands category, sales were above prior year by \$6.0 million. The licensed brands growth was primarily due to the launch of the new collection of Hugo Boss watches, which did not contribute significantly to revenues in the prior year.

Sales in the retail segment were \$20.5 million or 4.1% above prior year sales of \$19.7 million. The increase was driven by an overall 20.9% increase in Movado Boutique sales. This was the result of a 9.3% comparable store sales increase in the Movado Boutiques along with sales from four non-comparable stores year over year. Sales by the Company's outlet stores were below prior year by 7.1%. This was the result of an 8.7% comparable store sales decrease. The Company operated 28 Movado Boutiques and 29 outlet stores at July 31, 2006 compared to 27 Movado Boutiques and 28 outlet stores at July 31, 2005.

The Company considers comparable store sales to be sales of stores that were open as of February 1st of the last year through January 31st of the current year. The Company had 24 comparable Movado Boutiques and 26 comparable outlet stores for purposes of the three months ended July 31, 2006. The sales from stores that have been relocated, renovated or refurbished are included in the calculation of comparable store sales. The method of calculating comparative store sales varies across the retail industry. As a result, the calculation of comparative store sales may not be the same as measures reported by other companies.

Gross Profit. Gross profit for the three months ended July 31, 2006 was \$78.5 million or 62.0% of net sales as compared to \$70.0 million or 60.7% of net sales for the three months ended July 31, 2005. The increase in gross profit of \$8.5 million was primarily the result of the higher sales volume along with increases generated from the margin percentage improvement. The increase in gross profit as a percentage of sales was driven by higher margins in the Movado Boutiques due to both product mix and better jewelry margins. In addition, increases were recorded across most brands largely due to higher margin percentages on new product introductions.

Selling, General and Administrative ("SG&A"). Selling, general and administrative expenses for the three months ended July 31, 2006 were \$64.4 million or 50.9% of net sales as compared to \$57.7 million or 50.0% of net sales for the three months ended July 31, 2005. The dollar increase reflects spending primarily to invest in the Company's growth initiatives, including higher marketing spending of \$1.3 million to support the sales

growth initiatives, added spending of \$0.6 million in support of the retail expansion and higher payroll and related expenses of \$3.1 million reflecting salary increases, increased headcount to support the growth for both new and existing brands and higher equity compensation costs. In addition, as a result of the consolidation of the Company's majority-owned joint venture with TWC SA ("TWC") established to distribute the licensed brands in France and Germany, \$0.7 million of expense was included in the consolidated results.

Wholesale Operating Income. Operating income in the wholesale segment increased by \$1.0 million to \$13.2 million. The increase was the net result of higher gross profit of \$7.2 million, partially offset by the increase in SG&A expenses of \$6.2 million.

The higher gross margin of \$7.2 million was the result of the increase in net sales of \$10.5 million as well as improved gross margin percentage in most brands largely due to higher margins on new product introductions. The increase in the SG&A expenses of \$6.2 million was primarily due to higher marketing spending of \$1.3 million to support the sales growth initiatives and higher payroll and related expenses of \$3.1 million reflecting salary increases, increased headcount to support the growth for both new and existing brands and higher equity compensation costs. In addition, as a result of the consolidation of the Company's majority-owned joint venture with TWC, \$0.7 million of expense was recorded in the wholesale segment's results.

Retail Operating Income. Operating income of \$0.9 million and \$0.1 million were recorded in the retail segment for the three months ended July 31, 2006 and 2005, respectively.

The increase in operating income was the net result of higher gross profit of \$1.4 million offset by higher SG&A expenses of \$0.6 million. The increased gross profit was primarily attributed to improved margin percentage in the Movado Boutiques. The higher SG&A expenses were primarily the result of added spending for the seven non-comparable stores.

Interest Expense. Interest expense for the three months ended July 31, 2006 and 2005 was \$0.9 million for each period. Average borrowings were \$99.3 million at an average borrowing rate of 3.7% for the three months ended July 31, 2006 compared to average borrowings of \$72.1 million at an average rate of 5.2% for the three months ended July 31, 2005. The lower average borrowing rate was due to the shifting of debt from the U.S. to Switzerland, which is at a more favorable borrowing rate.

Interest Income. Interest income was approximately \$0.6 million for the three months ended July 31, 2006 as compared to approximately \$40 thousand for the three months ended July 31, 2005. The repatriated foreign earnings of \$150.0 million in the fourth quarter of fiscal year 2006 under the American Jobs Creation Act of 2004 resulted in significantly higher cash balances in the United States. The cash invested in the United States generated interest income at the rate of 4.9%.

Income Taxes. The Company recorded a tax expense of \$2.4 million for the three months ended July 31, 2006 as compared to a tax expense of \$2.9 million for the three months ended July 31, 2005. Taxes were recorded at an effective tax rate of 17.5% and 25.0% for the three months ended July 31, 2006 and 2005, respectively. The lower effective tax rate was the result of the Company's adoption of tax planning strategies in Switzerland which will enable it to utilize a greater portion of the acquired Ebel net operating loss carryforward.

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Net Income. For the three months ended July 31, 2006, the Company recorded net income of \$11.3 million as compared to \$8.6 million for the three months ended July 31, 2005.

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Results of operations for the six months ended July 31, 2006 as compared to the six months ended July 31, 2005

Net Sales: Comparative net sales by business segment were as follows (in thousands):

	Six Months Ended July 31,	
	2006	2005
Wholesale:		
Domestic	\$129,688	\$122,487
International	57,422	45,776
Retail	37,222	34,819
	\$224,332	\$203,082
	=====	=====

Net sales increased by \$21.3 million or 10.5% for the six months ended July 31, 2006 as compared to the six months ended July 31, 2005.

Sales in the domestic wholesale segment were \$129.7 million or 5.9% above prior year sales of \$122.5 million. The increase of \$7.2 million was primarily attributed to higher sales in the accessible luxury brands. Movado sales were above prior year by \$7.2 million as major chain and department stores had increased sell through at retail. ESQ sales were above prior year by \$1.9 million primarily due to new door openings as the brand continues to gain positive retailer response to the new model introductions as well as the ESQ&U marketing campaign. In the luxury brands category, Ebel sales were relatively flat year over year while Concord sales declined by \$3.9 million as planned. The Company is in the process of developing a strategic plan for the re-launch of the Concord brand. Sales in the licensed brands category were above the prior year period by \$1.5 million.

Sales in the international wholesale segment were \$57.4 million or 25.4% above prior year sales of \$45.8 million. In the luxury brands category, sales increased by \$6.1 million. Increased sales of \$8.4 million were recorded for Ebel primarily due to the Brasilia collection launch, while lower sales of \$2.3 million were recorded in Concord for the same reasons as in the domestic wholesale segment. In the accessible luxury brands category, Movado sales were below prior year by \$2.6 million due to planned reductions in the brand's overseas distribution. In the licensed brands category, sales were above prior year by \$8.7 million primarily driven by the launch of the new collection of Hugo Boss watches, which did not contribute significantly to revenues in the prior year.

Sales in the retail segment were \$37.2 million or 6.9% above prior year sales of \$34.8 million. The increase was driven by an overall 16.6% increase in Movado

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Boutique sales. This was the result of a 7.0% comparable store sales increase in the Movado Boutiques along with sales from four non-comparable stores year over year. Sales by the Company's outlet stores were below prior year by 0.9%. This was the result of a 2.6% comparable store sales decrease somewhat offset by higher sales from non-comparable stores year over year. The Company operated 28 Movado Boutiques and 29 outlet stores at July 31, 2006 compared to 27 Movado Boutiques and 28 outlet stores at July 31, 2005.

Gross Profit. Gross profit for the six months ended July 31, 2006 was \$138.1 million or 61.6% of net sales as compared to \$122.8 million or 60.5% of net sales for the six months ended July 31, 2005. The increase in gross profit of \$15.3 million was primarily the result of the higher sales volume. The increase in gross profit as a

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percentage of sales was driven by higher margins in the Movado Boutiques due to both product mix and better jewelry margins. In addition, percentage increases were recorded across most brands largely due to new product introductions.

Selling, General and Administrative. Selling, general and administrative expenses for the six months ended July 31, 2006 were \$120.6 million or 53.8% of net sales as compared to \$108.4 million or 53.4% of net sales for the six months ended July 31, 2005. The increase reflects spending primarily to invest in the Company's growth initiatives, including higher marketing spending of \$2.5 million to support the sales growth initiatives, added spending of \$1.2 million in support of the retail expansion and higher payroll and related expenses of \$5.2 million reflecting salary increases, increased headcount to support the growth for both new and existing brands and higher equity compensation costs. In addition, as a result of the consolidation of the Company's majority-owned joint venture with TWC, \$1.1 million of expense was included in the consolidated results.

Wholesale Operating Income. Operating income in the wholesale segment increased by \$2.0 million to \$17.9 million. The increase was the net result of higher gross profit of \$13.0 million, partially offset by the increase in SG&A expenses of \$11.0 million.

The higher gross margin of \$13.0 million was primarily the result of the increase in net sales of \$18.8 million. The increase in the SG&A expenses of \$11.0 million was primarily due to higher marketing spending of \$2.5 million to support the sales growth initiatives and higher payroll and related expenses of \$5.2 million reflecting salary increases, increased headcount to support the growth for both new and existing brands and higher equity compensation costs. In addition, as a result of the consolidation of the Company's majority-owned joint venture with TWC, \$1.1 million of expense was recorded in the wholesale segment's results.

Retail Operating Loss. Operating losses of \$0.4 million and \$1.5 million were recorded in the retail segment for the six months ended July 31, 2006 and 2005, respectively.

The decrease in operating loss was the net result of higher gross profit of \$2.3 million offset by higher SG&A expenses of \$1.2 million. The increased gross profit was primarily attributable to improved margin percentage in the Movado Boutiques. The higher SG&A expenses were primarily the result of added spending for the seven non-comparable stores.

Interest Expense. Interest expense for the six months ended July 31, 2006 and

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2005 was \$1.9 million and \$1.8 million, respectively. Average borrowings were \$102.8 million at an average borrowing rate of 3.6% for the six months ended July 31, 2006 compared to average borrowings of \$61.9 million at an average rate of 5.4% for the six months ended July 31, 2005. The lower average borrowing rate was due to the shifting of debt from the U.S. to Switzerland, which is at a more favorable borrowing rate.

Interest Income. Interest income was \$1.5 million for the six months ended July 31, 2006 as compared to \$0.1 million for the six months ended July 31, 2005. The repatriated foreign earnings of \$150.0 million in the fourth quarter of fiscal year 2006 under the American Jobs Creation Act of 2004 resulted in significantly higher cash balances in the United States. The cash invested in the United States generated interest income at the rate of 4.7%.

Income Taxes. The Company recorded a tax expense of \$3.0 million for the six months ended July 31, 2006 as compared to a tax expense of \$3.2 million for the six months ended July 31, 2005. Taxes were recorded at an effective tax rate of 17.5% and 25.0% for the six months ended July 31, 2006 and 2005, respectively. The lower effective tax rate is the result of the Company's adoption of tax planning strategies in Switzerland which will enable it to utilize a greater portion of the acquired Ebel net operating loss carryforward.

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Net Income. For the six months ended July 31, 2006, the Company recorded net income of \$14.2 million as compared to \$9.5 million for the six months ended July 31, 2005.

### LIQUIDITY AND CAPITAL RESOURCES

Cash used in operating activities was \$24.4 million for the six months ended July 31, 2006 as compared to \$25.5 million for the six months ended July 31, 2005. The cash used in operating activities reflects the historic pattern of the Company to fund its working capital needs in the first half of the year due to the seasonal nature of the business. For the six months ended July 31, 2006, the most significant changes in operating assets were the increases in accounts receivable of \$17.9 million, primarily resulting from the growth in sales and an increase of \$13.1 million in inventory levels, primarily in anticipation of the upcoming holiday selling season. In addition, \$9.5 million of cash was used to reduce total current liabilities but was offset by cash from net earnings of \$14.2 million for the six months ended July 31, 2006. For the six months ended July 31, 2005, the most significant changes in operating assets were the increases in accounts receivable of \$3.8 million, primarily resulting from the growth in sales and an increase of \$27.1 million in inventory levels. This was partially offset by net earnings of \$9.5 million for the six months ended July 31, 2005.

Cash used in investing activities amounted to \$7.2 million and \$8.2 million for the six months ended July 31, 2006 and 2005, respectively. The cash used during both periods consisted of the capital expenditures primarily related to the expansion and renovations of retail stores, the acquisition of tooling for new product introductions and computer hardware and software enhancements. Capital expenditures in the 2005 period also included the acquisition of machinery and equipment to further automate distribution activities.

Cash used in financing activities amounted to \$15.8 million for the six months ended July 31, 2006 compared to cash provided of \$34.2 million for the six months ended July 31, 2005. Cash used in financing activities for the six months ended July 31, 2006 was primarily to pay down long-term debt, while cash provided in the six months ended July 31, 2005 resulted primarily from

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short-term borrowings required to fund the Company's working capital needs.

During fiscal 1999, the Company issued \$25.0 million of Series A Senior Notes under a Note Purchase and Private Shelf Agreement dated November 30, 1998. These notes bear interest of 6.90% per annum, mature on October 30, 2010 and are subject to annual repayments of \$5.0 million commencing October 31, 2006. These notes contain certain financial covenants including an interest coverage ratio and maintenance of consolidated net worth and certain non-financial covenants that restrict the Company's activities regarding investments and acquisitions, mergers, certain transactions with affiliates, creation of liens, asset transfers, payment of dividends and limitation of the amount of debt outstanding. At July 31, 2006, the Company was in compliance with all financial and non-financial covenants and \$25.0 million of these notes were issued and outstanding.

As of March 21, 2004, the Company amended its Note Purchase and Private Shelf Agreement, originally dated March 21, 2001, to expire on March 21, 2007. This agreement allows for the issuance, for up to three years after the date thereof, of senior promissory notes in the aggregate principal amount of up to \$40.0 million with maturities up to 12 years from their original date of issuance. On October 8, 2004, the Company issued, pursuant to the Note Purchase Agreement, 4.79% Senior Series A-2004 Notes due 2011 (the "Senior Series A-2004 Notes"), in an aggregate principal amount of \$20.0 million, which will mature on October 8, 2011 and are subject to annual repayments of \$5.0 million commencing on October 8, 2008. Proceeds of the Senior Series A-2004 Notes have been used by the Company for capital expenditures, repayment of certain of its debt obligations and general corporate purposes. These notes contain certain financial covenants, including an interest coverage ratio and maintenance of consolidated net worth and certain non-financial covenants that restrict the Company's activities regarding investments and acquisitions, mergers, certain transactions with affiliates, creation of liens, asset transfers, payment of dividends and limitation of the amount of debt

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outstanding. As of July 31, 2006, the Company was in compliance with all financial and non-financial covenants and \$20.0 million of these notes were issued and outstanding.

On December 15, 2005, the Company as parent guarantor, and its Swiss subsidiaries, MGI Luxury Group S.A. and Movado Watch Company SA as borrowers, entered into a credit agreement with JPMorgan Chase Bank, N.A., JPMorgan Securities, Inc., Bank of America, N.A., The Bank of New York and Citibank, N.A. (the "Swiss Credit Agreement") which provides for a revolving credit facility of 90.0 million Swiss francs and matures on December 15, 2010. The obligations of the Company's two Swiss subsidiaries under this credit agreement are guaranteed by the Company under a Parent Guarantee, dated as of December 15, 2005, in favor of the lenders. The Swiss Credit Agreement contains financial covenants, including an interest coverage ratio, average debt coverage ratio and limitations on capital expenditures and certain non-financial covenants that restrict the Company's activities regarding investments and acquisitions, mergers, certain transactions with affiliates, creation of liens, asset transfers, payment of dividends and limitation of the amount of debt outstanding. Borrowings under the Swiss Credit Agreement bear interest at a rate equal to the LIBOR (as defined in the Swiss Credit Agreement) plus a margin ranging from .50% per annum to .875% per annum (depending upon a leverage ratio). As of July 31, 2006, the Company was in compliance with all financial and non-financial covenants and had 64.0 million Swiss francs, with a dollar equivalent of \$52.0 million, outstanding under this revolving credit facility.

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On December 15, 2005, the Company and its Swiss subsidiaries, MGI Luxury Group S.A. and Movado Watch Company SA, entered into a credit agreement with JPMorgan Chase Bank, N.A., JPMorgan Securities, Inc., Bank of America, N.A., The Bank of New York and Citibank, N.A. (the "US Credit Agreement") which provides for a revolving credit facility of \$50.0 million (including a sublimit for borrowings in Swiss francs of up to \$25.0 million) with a provision to allow for an increase of an additional \$50.0 million subject to certain terms and conditions. The US Credit Agreement will mature on December 15, 2010. The obligations of MGI Luxury Group S.A. and Movado Watch Company SA are guaranteed by the Company under a Parent Guarantee, dated as of December 15, 2005, in favor of the lenders. The obligations of the Company are guaranteed by certain domestic subsidiaries of the Company under subsidiary guarantees, in favor of the lenders. The US Credit Agreement contains financial covenants, including an interest coverage ratio, average debt coverage ratio and limitations on capital expenditures and certain non-financial covenants that restrict the Company's activities regarding investments and acquisitions, mergers, certain transactions with affiliates, creation of liens, asset transfers, payment of dividends and limitation of the amount of debt outstanding. Borrowings under the US Credit Agreement bear interest, at the Company's option, at a rate equal to the Adjusted LIBOR (as defined in the US Credit Agreement) plus a margin ranging from .50% per annum to .875% per annum (depending upon a leverage ratio), or the Alternate Base Rate (as defined in the US Credit Agreement). As of July 31, 2006, the Company was in compliance with all financial and non-financial covenants, and there were no outstanding borrowings against this line.

On June 16, 2006, the Company renewed a line of credit letter agreement with Bank of America and an amended and restated promissory note in the principal amount of up to \$20.0 million payable to Bank of America, originally dated December 12, 2005. Pursuant to the line of credit letter agreement, Bank of America will consider requests for short-term loans and documentary letters of credit for the importation of merchandise inventory, the aggregate amount of which at any time outstanding shall not exceed \$20.0 million. The Company's obligations under the agreement are guaranteed by its subsidiaries, Movado Retail Group, Inc. and Movado LLC. Pursuant to the amended and restated promissory note, the Company promised to pay to Bank of America \$20.0 million, or such lesser amount as may then be the unpaid balance of all loans made by Bank of America to the Company thereunder, in immediately available funds upon the maturity date of June 16, 2007. The Company has the right to prepay all or part of any outstanding amounts under the promissory note without penalty at any time prior to the maturity date. The amended and restated promissory note bears interest at an annual rate equal to either (i) a floating rate equal to the prime rate or (ii) such fixed rate as may be agreed upon

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by the Company and Bank of America for an interest period which is also then agreed upon. The amended and restated promissory note contains various representations and warranties and events of default that are customary for instruments of that type. As of July 31, 2006, there were no outstanding borrowings against this line.

On July 31, 2006, the Company renewed a promissory note, originally dated December 13, 2005, in the principal amount of up to \$37.0 million, at a revised amount of up to \$7.0 million, payable to JPMorgan Chase Bank, N.A. ("Chase"). Pursuant to the promissory note, the Company promised to pay to Chase \$7.0 million, or such lesser amount as may then be the unpaid balance of each loan made or letter of credit issued by Chase to the Company thereunder, upon the maturity date of July 31, 2007. The Company has the right to prepay all or part

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of any outstanding amounts under the promissory note without penalty at any time prior to the maturity date. The promissory note bears interest at an annual rate equal to either (i) a floating rate equal to the prime rate, (ii) a fixed rate equal to an adjusted LIBOR plus 0.625% or (iii) a fixed rate equal to a rate of interest offered by Chase from time to time on any single commercial borrowing. The promissory note contains various events of default that are customary for instruments of that type. In addition, it is an event of default for any security interest or other encumbrance to be created or imposed on the Company's property, other than as permitted in the lien covenant of the US Credit Agreement. Chase issued 11 irrevocable standby letters of credit for retail and operating facility leases to various landlords, for the administration of the Movado Boutique private-label credit card and Canadian payroll to the Royal Bank of Canada totaling \$1.2 million with expiration dates through August 31, 2007. As of July 31, 2006, there were no outstanding borrowings against this promissory note.

A Swiss subsidiary of the Company maintains unsecured lines of credit with an unspecified length of time with a Swiss bank. Available credit under these lines totaled 8.0 million Swiss francs, with dollar equivalents of \$6.5 million and \$6.2 million at July 31, 2006 and 2005, respectively. As of July 31, 2006, two European banks have guaranteed obligations to third parties on behalf of two of the Company's foreign subsidiaries in the amount of \$3.3 million in various foreign currencies. As of July 31, 2006, there were no outstanding borrowings against these lines.

The Company paid dividends per share of \$0.06 or approximately \$3.1 million, for the six months ended July 31, 2006 and \$0.05 per share or approximately \$2.5 million for the six months ended July 31, 2005.

Cash and cash equivalents at July 31, 2006 amounted to \$78.1 million compared to \$50.3 million at July 31, 2005. The increase in cash and cash equivalents primarily relates to the Company's borrowings in the fourth quarter of fiscal 2006 to repatriate foreign earnings to the United States under the American Jobs Creation Act of 2004.

Management believes that the cash on hand in addition to the expected cash flow from operations and the Company's short-term borrowing capacity will be sufficient to meet its working capital needs for at least the next 12 months.

### Off-Balance Sheet Arrangements

The Company does not have off-balance sheet financing or unconsolidated special-purpose entities.

### RECENTLY ISSUED ACCOUNTING STANDARDS

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109)" which is effective for fiscal years beginning after December 15, 2006. This interpretation clarifies the accounting for uncertainty in income taxes recognized in the financial statements by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is currently evaluating the impact of this interpretation.



## Item 3. Quantitative and Qualitative Disclosure about Market Risks

## Foreign Currency and Commodity Price Risks

A significant portion of the Company's purchases are denominated in Swiss francs. The Company reduces its exposure to the Swiss franc exchange rate risk through a hedging program. Under the hedging program, the Company manages most of its foreign currency exposures on a consolidated basis, which allows it to net certain exposures and take advantage of natural offsets. The Company uses various derivative financial instruments to further reduce the net exposures to currency fluctuations, predominately forward and option contracts. These derivatives either (a) are used to hedge the Company's Swiss franc liabilities and are recorded at fair value with the changes in fair value reflected in earnings or (b) are documented as cash flow hedges with the gains and losses on this latter hedging activity first reflected in other comprehensive income, and then later classified into earnings in accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), as amended by SFAS No. 137, SFAS No. 138 and SFAS No. 149. In both cases, the earnings impact is partially offset by the effects of currency movements on the underlying hedged transactions. If the Company did not engage in a hedging program, any change in the Swiss franc to local currency would have an equal effect on the Company's cost of sales. In addition, the Company hedges its Swiss franc payable exposure with forward contracts. As of July 31, 2006, the Company's entire net forward contracts hedging portfolio consisted of 128.0 million Swiss francs equivalent for various expiry dates ranging through July 20, 2007. If the Company were to settle its Swiss franc forward contracts at July 31, 2006, the net result would have been a gain of \$0.9 million, net of tax of \$0.6 million. As of July 31, 2006, the Company had 31.0 million Swiss franc option contracts related to cash flow hedges for various expiry dates ranging through April 30, 2007. If the Company were to settle its Swiss franc option contracts at July 31, 2006, the net result would have been a net loss of approximately \$70 thousand.

The Company's Board of Directors authorized the hedging of the Company's Swiss franc denominated investment in its wholly-owned Swiss subsidiaries using purchase options under certain limitations. These hedges are treated as net investment hedges under SFAS No. 133. As of July 31, 2006, the Company did not hold a purchased option hedge portfolio related to net investment hedging.

## Commodity Risk

Additionally, the Company has a hedging program related to gold used in the manufacturing of the Company's watches. Under this hedging program, the Company purchases various commodity derivative instruments, primarily future contracts. These derivatives are documented as SFAS No. 133 cash flow hedges, and gains and losses on these derivative instruments are first reflected in other comprehensive income, and later reclassified into earnings, partially offset by the effects of gold market price changes on the underlying actual gold purchases. If the Company did not engage in a gold hedging program, any changes in the gold price would have an equal effect on the Company's cost of sales. The Company did not hold any futures contracts in its gold hedge portfolio related to cash flow hedges as of July 31, 2006.

## Debt and Interest Rate Risk

In addition, the Company has certain debt obligations with variable interest rates, which are based on Swiss LIBOR plus a fixed additional interest rate. The Company does not hedge these interest rate risks. The Company also has certain

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debt obligations with fixed interest rates. The differences between the market based interest rates at July 31, 2006, and the fixed rates were unfavorable. The Company believes that a 1% change in interest rates would affect the Company's net income by approximately \$0.5 million.

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### Item 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures, as such terms are defined in Rule 13a-15(e) under the Securities Exchange Act, as amended. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report.

It should be noted that while the Company's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the Company's disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

#### Changes in Internal Control Over Financial Reporting

There has been no change in the Company's internal control over financial reporting during the three months ended July 31, 2006, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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## PART II - OTHER INFORMATION

### Item 1A. Risk Factors

As of July 31, 2006, there have been no material changes to any of the risk factors previously reported in its Annual Report on Form 10-K for the fiscal year ended January 31, 2006.

### Item 6. Exhibits

- 10.1 Line of Credit Letter Agreement dated as of June 16, 2006 between the Registrant and Bank of America, N.A. and Amended and Restated Promissory Note dated as of June 16, 2006 to Bank of America, N.A.
- 10.2 Promissory Note dated as of July 31, 2006 to JPMorgan Chase Bank, N.A.
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302

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of the Sarbanes-Oxley Act of 2002.

- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURE

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MOVADO GROUP, INC.  
(Registrant)

Dated: September 7, 2006

By: /s/ Eugene J. Karpovich

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Eugene J. Karpovich  
Senior Vice President and  
Chief Financial Officer  
(Chief Financial Officer)  
(Duly Authorized Officer)

/s/ Ernest R. LaPorte

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Ernest R. LaPorte  
Vice President of Finance  
(Principal Accounting Officer)

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