FOSSIL INC
Form 10-Q
November 13, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: October 4, 2008

OR

o **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: 0-19848

FOSSIL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**75-2018505**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2280 N. Greenville Avenue, Richardson, Texas 75082

(Address of principal executive offices)

(Zip Code)

(972) 234-2525

(Registrant s telephone number, including area code)

Indicate by check mark whether 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 x No o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

The number of shares of registrant s common stock outstanding as of November 11, 2008: 66,612,010

PART I - FINANCIAL INFORMATION

Item 1. **Financial Statements**

FOSSIL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

AMOUNTS IN THOUSANDS

	October 4, 2008	January 5, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 117,811	$ 255,244
Securities available for sale	7,432	12,626
Accounts receivable - net of allowances of $48,967 and $51,801, respectively	229,296	227,481
Inventories - net	331,614	248,448
Deferred income tax assets - net	25,188	24,221
Prepaid expenses and other current assets	67,479	56,797
Total current assets	778,820	824,817
Investments	13,564	13,902
Property, plant and equipment - net of accumulated depreciation of $153,087 and $134,847, respectively	201,239	186,042
Goodwill	44,326	45,485
Intangible and other assets - net of accumulated amortization of $6,679 and $5,589, respectively	60,480	52,382
Total assets	$ 1,098,429	$ 1,122,628
Liabilities and Stockholders Equity		
Current liabilities:		
Short-term debt	$ 4,485	$ 9,993
Accounts payable	108,107	111,015
Accrued expenses:		
Compensation	38,087	44,224
Royalties	15,799	22,524
Co-op advertising	13,132	17,769
Other	29,510	32,833
Income taxes payable	42,481	40,049
Total current liabilities	251,601	278,407
Long-term income taxes payable	41,396	38,455
Deferred income tax liabilities	17,462	16,168
Long-term debt	3,367	3,452
Other long-term liabilities	10,796	8,357
Total long-term liabilities	73,021	66,432

Minority interest in subsidiaries		5,777		6,127
Stockholders equity:				
Common stock, 67,038 and 69,713 shares issued at 2008 and 2007, respectively		670		697
Additional paid-in capital		80,526		88,000
Retained earnings		658,873		646,492
Accumulated other comprehensive income		27,961		36,473
Total stockholders equity		768,030		771,662
Total liabilities and stockholders equity	$	1,098,429	$	1,122,628

See notes to the condensed consolidated financial statements.

FOSSIL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

AND COMPREHENSIVE INCOME

UNAUDITED

AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA

	For the 13 Weeks Ended		For the 39 Weeks Ended	
	October 4, 2008	October 6, 2007	October 4, 2008	October 6, 2007
Net sales	$ 409,760	$ 358,582	$ 1,119,136	$ 969,871
Cost of sales	185,583	171,626	510,369	476,265
Gross profit	224,177	186,956	608,767	493,606
Operating expenses:				
Selling and distribution	120,644	98,567	341,365	273,023
General and administrative	39,795	39,935	119,588	116,458
Total operating expenses	160,439	138,502	460,953	389,481
Operating income	63,738	48,454	147,814	104,125
Interest expense	79	174	371	613
Other (expense) income - net	(4,035)	1,391	(8,361)	3,228
Income before income taxes	59,624	49,671	139,082	106,740
Provision for income taxes	23,153	19,218	47,257	36,583
Net income	$ 36,471	$ 30,453	$ 91,825	$ 70,157
Other comprehensive income (loss), net of taxes:				
Currency translation adjustment	(33,432)	6,630	(19,324)	14,336
Unrealized loss on securities available for sale	(467)	(276)	(1,140)	(339)
Forward contracts hedging intercompany foreign currency payments - change in fair values	15,423	(2,309)	11,952	(3,568)
Total comprehensive income	$ 17,995	$ 34,498	$ 83,313	$ 80,586
Earnings per share:				
Basic	$ 0.54	$ 0.45	$ 1.35	$ 1.03
Diluted	$ 0.54	$ 0.43	$ 1.33	$ 1.00
Weighted average common shares outstanding:				
Basic	67,261	68,143	67,931	67,844
Diluted	68,049	70,302	68,881	70,112

See notes to the condensed consolidated financial statements.

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FOSSIL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

AMOUNTS IN THOUSANDS

	For the 39 Weeks Ended October 4, 2008	For the 39 Weeks Ended October 6, 2007
Operating Activities:		
Net income	$ 91,825	$ 70,157
Noncash items affecting net income:		
Depreciation and amortization	27,763	23,819
Stock-based compensation	5,262	3,558
Minority interest in subsidiaries	4,932	3,469
Increase in allowance for returns - net of related inventory in transit	187	1,066
Loss on disposal of assets	141	256
Impairment loss	1,116	
Equity in income of joint venture	(1,211)	(1,447)
Increase in allowance for doubtful accounts	918	57
Excess tax benefits from stock-based compensation	(535)	(9,391)
Deferred income taxes	(1,061)	(717)
Changes in operating assets and liabilities, net of effects of acquisitions:		
Income taxes payable	3,958	16,330
Accrued expenses	(19,208)	17,414
Inventories	(87,104)	(40,788)
Prepaid expenses and other current assets	(10,682)	(19,482)
Accounts payable	1,063	27,117
Accounts receivable	1,018	(46,547)
Net cash from operating activities	18,382	44,871
Investing Activities:		
Additions to property, plant and equipment	(40,548)	(24,074)
Increase in intangible and other assets	(13,274)	(4,847)
Purchase of securities available for sale	(1,847)	(2,176)
Sales/maturities of securities available for sale	6,395	496
Business acquisitions, net of cash acquired		(1,326)
Net cash used in investing activities	(49,274)	(31,927)
Financing Activities:		
Acquisition and retirement of common stock	(94,888)	(287)
Distribution of minority interest earnings	(4,359)	(2,107)
Excess tax benefits from stock-based compensation	535	9,391
Borrowings on notes payable		5,438
Payments on notes payable	(6,209)	(2,176)
Proceeds from exercise of stock options	4,297	19,691
Net cash (used in) from financing activities	(100,624)	29,950
Effect of exchange rate changes on cash and cash equivalents	(5,916)	8,564

Net (decrease) increase in cash and cash equivalents		(137,433)		51,458
Cash and cash equivalents:				
Beginning of period		255,244		133,304
End of period	$	117,811	$	184,762

See notes to the condensed consolidated financial statements.

FOSSIL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

1. FINANCIAL STATEMENT POLICIES

Basis of Presentation. The condensed consolidated financial statements include the accounts of Fossil, Inc., a Delaware corporation, and its wholly and majority-owned subsidiaries (the Company). The condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary to present a fair statement of the Company s financial position as of October 4, 2008, and the results of operations for the thirteen-week periods ended October 4, 2008 (Third Quarter) and October 6, 2007 (Prior Year Quarter), respectively, and the thirty-nine week periods ended October 4, 2008 (Year To Date Period) and October 6, 2007 (Prior Year YTD Period), respectively. All adjustments are of a normal, recurring nature.

These interim financial statements should be read in conjunction with the audited financial statements and the notes thereto included in the annual report on Form 10-K filed by the Company pursuant to the Securities Exchange Act of 1934 (the Exchange Act) for the year ended January 5, 2008. Operating results for the thirty-nine week period ended October 4, 2008 are not necessarily indicative of the results to be achieved for the full year.

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the periods reported. Actual results could differ from those estimates. The Company has not made any changes in its significant accounting policies from those disclosed in its most recent annual report.

Business. The Company is a global design, marketing and distribution company that specializes in consumer fashion accessories. Its principal offerings include an extensive line of men s and women s fashion watches and jewelry, handbags, small leather goods, belts, sunglasses, and apparel. In the watch and jewelry product category, the Company has a diverse portfolio of globally recognized owned and licensed brand names under which its products are marketed. The Company s products are distributed globally through various distribution channels including wholesale, export and direct to the consumer at varying price points to service the needs of its customers, whether they are value conscious or luxury oriented. Based on its extensive range of accessory products, brands, distribution channels and price points, the Company is able to target style-conscious consumers across a wide age spectrum on a global basis.

Foreign Currency Hedging Instruments. The Company s foreign subsidiaries periodically enter into forward contracts principally to hedge the future payment of intercompany inventory transactions in U.S. dollars. At October 4, 2008, the Company s foreign subsidiaries had forward contracts to sell (i) 87.1 million Euro for approximately $127.0 million, expiring through December 2009, (ii) approximately 10.0 million British Pounds for $19.9 million, expiring through April 2009, and (iii) approximately 6.2 million Australian Dollars for $5.7 million, expiring through February 2009. If the Company s foreign subsidiaries were to settle their Euro, British Pound, and Australian Dollar based contracts at the reporting date, the net result would be a gain of approximately $5.9 million, net of taxes, as of October 4, 2008. The net increase in fair value for the Year To Date Period of approximately $12.0 million and the net decrease in fair value for the Prior Year YTD Period of approximately $3.6 million is included in other comprehensive income. The net increase for the Year To Date Period consisted of net gains from these hedges of $9.9 million and approximately $2.1 million of net losses reclassified into earnings.

The tax (expense) benefit of the changes in fair value of hedging activity included in other comprehensive income is as follows:

	For the 13 Weeks Ended		For the 39 Weeks Ended	
IN THOUSANDS	**October 4, 2008**	**October 6, 2007**	**October 4, 2008**	**October 6, 2007**
	$ (1,760)	$ 172	$ (1,444)	$ 304

Fair Value Measurements. The Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS 157) as of January 6, 2008, with the exception of the application of the statement to non-recurring, non-financial assets and liabilities as permitted. The adoption of SFAS 157 did not have a material impact on the Company s fair value measurements. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date.

SFAS 157 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
- Level 2 - Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly.
- Level 3 - Unobservable inputs based on the Company s assumptions.

SFAS 157 requires the use of observable market data if such data is available without undue cost and effort.

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of October 4, 2008:

	Level 1	Level 2	Level 3	Total
Assets:				
Securities available for sale	$ 7,432	$	$	$ 7,432
Foreign exchange forward contracts		9,943		9,943
Total	$ 7,432	$ 9,943	$	$ 17,375

The fair values of the Company s available-for-sale securities are based on quoted prices. The foreign exchange forward contracts are entered into by the Company principally to hedge the future payment of intercompany inventory transactions by non-U.S. subsidiaries. The fair values of the Company s foreign exchange forward contracts are based on published quotations of spot currency rates and forward points, which are converted into implied forward currency rates and are recorded as an asset within prepaid expenses and other current assets.

Earnings Per Share. The following table reconciles the numerators and denominators used in the computations of both basic and diluted earnings per share (EPS):

	For the 13 Weeks Ended		For the 39 Weeks Ended	
	October 4, 2008	October 6, 2007	October 4, 2008	October 6, 2007
IN THOUSANDS, EXCEPT PER SHARE DATA				
Numerator:				
Net income	$ 36,471	$ 30,453	$ 91,825	$ 70,157
Denominator:				
Basic EPS computations:				
Basic weighted average common shares outstanding	67,261	68,143	67,931	67,844
Basic EPS	$ 0.54	$ 0.45	$ 1.35	$ 1.03

Diluted EPS computation:								
Basic weighted average common shares outstanding		67,261		68,143		67,931		67,844
Stock options, stock appreciation rights, unvested restricted stock and restricted stock units		788		2,159		950		2,268
Diluted weighted average common shares outstanding		68,049		70,302		68,881		70,112
Diluted EPS	$	0.54	$	0.43	$	1.33	$	1.00

Approximately 420,000, 2,000, 222,000 and 115,000 weighted average shares issuable under stock-based awards were not included in the diluted earnings per share calculation at the end of the Third Quarter, Prior Year Quarter, Year To Date Period and Prior Year YTD Period, respectively, because they were antidilutive. These common share equivalents may be dilutive in future EPS calculations.

Goodwill. The changes in the carrying amount of goodwill, which is not subject to amortization, are as follows:

IN THOUSANDS		United States - wholesale		Europe - wholesale		Other International - wholesale		Direct to Consumer		Total
Balance at January 5, 2008	$	21,799	$	18,908	$	4,778	$		$	45,485
Currency				(1,103)		(56)				(1,159)
Balance at October 4, 2008	$	21,799	$	17,805	$	4,722	$		$	44,326

Newly Issued Accounting Standards. In May 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 162). This statement identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. The issuance of SFAS No. 162 is not expected to have a material impact on the Company s condensed consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement 133* (SFAS 161). SFAS 161 expands the current disclosure requirements of SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* such that entities must now provide enhanced disclosures on a quarterly basis regarding how and why the entity uses derivatives, how derivatives and related hedged items are accounted for under SFAS 133 and how derivatives and related hedged items affect the entity s financial position, performance and cash flow. Pursuant to the transition provisions of SFAS 161, the Company will adopt SFAS 161 in fiscal year 2009 and will present the required disclosures in the prescribed format on a prospective basis. SFAS 161 will not impact the consolidated results of operations or financial condition as it is disclosure-only in nature.

Newly Adopted Accounting Standards. In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement 115* (SFAS 159). SFAS 159 introduces the fair value option, which permits entities to choose to measure eligible financial instruments at fair value at specified election dates. An entity must report unrealized gains and losses on the items on which it has elected the fair value option in earnings at each subsequent reporting date. SFAS 159 was effective for the Company effective January 6, 2008. The adoption of SFAS 159 did not have an impact on the Company s consolidated results of operations or financial condition as the Company did not elect to adopt the fair value option for any of its financial assets or liabilities.

In September 2006, the FASB issued SFAS No. 157. SFAS 157 provides guidance for using fair value to measure assets and liabilities. Under SFAS 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007; however, the FASB provided a one year deferral for implementation of the standard for non-recurring, non-financial assets and liabilities. The Company adopted SFAS 157, effective January 6, 2008, for all financial assets and liabilities as required. The Company does not expect the standard to have a material impact on its consolidated financial statements when fully adopted in fiscal year 2009.

2. INVENTORIES

Inventories net consist of the following:

	October 4, 2008	January 5, 2008
	IN THOUSANDS	
Components and parts	$ 23,209	$ 15,615
Work-in-process	5,073	5,129
Inventory purchases in-transit	46,407	23,826
Finished goods	271,030	217,097
	345,719	261,667
Inventory obsolescence reserve	(14,105)	(13,219)