

SKECHERS USA INC  
Form 10-Q  
November 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

OR

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

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

Commission File Number 001-14429

SKECHERS U.S.A., INC.

(Exact name of registrant as specified in its charter)

Delaware 95-4376145  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

228 Manhattan Beach Blvd.

Manhattan Beach, California 90266  
(Address of Principal Executive Office) (Zip Code)

(310) 318-3100

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of Class A Common Stock outstanding as of November 1, 2018: 133,880,258.

The number of shares of Class B Common Stock outstanding as of November 1, 2018: 24,163,312.

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

FORM 10-Q

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

Item 1.	<u>Condensed Consolidated Financial Statements (Unaudited):</u>	
	<u>Condensed Consolidated Balance Sheets</u>	3
	<u>Condensed Consolidated Statements of Earnings</u>	4
	<u>Condensed Consolidated Statements of Comprehensive Income</u>	5
	<u>Condensed Consolidated Statements of Cash Flows</u>	6
	<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	21
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	32
Item 4.	<u>Controls and Procedures</u>	33

PART II – OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	34
Item 1A.	<u>Risk Factors</u>	35
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	37
Item 3.	<u>Defaults Upon Senior Securities</u>	37
Item 4.	<u>Mine Safety Disclosures</u>	37
Item 5.	<u>Other Information</u>	37
Item 6.	<u>Exhibits</u>	38
		39

Signatures

2

---

## PART I – FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par values)

	September 30, 2018	December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$802,771	\$736,431
Short-term investments	87,277	—
Trade accounts receivable, less allowances of \$25,609 in 2018 and \$51,180 in 2017	503,954	405,921
Other receivables	48,843	27,083
Total receivables	552,797	433,004
Inventories	755,068	873,016
Prepaid expenses and other current assets	83,085	62,573
Total current assets	2,280,998	2,105,024
Property, plant and equipment, net	565,395	541,601
Deferred tax assets	28,224	29,922
Long-term investments	91,086	17,396
Other assets, net	38,772	41,139
Total non-current assets	723,477	630,058
<b>TOTAL ASSETS</b>	<b>\$3,004,475</b>	<b>\$2,735,082</b>
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Current installments of long-term borrowings	\$4,581	\$1,801
Short-term borrowings	12,674	8,011
Accounts payable	528,077	505,334
Accrued expenses	119,584	82,202
Total current liabilities	664,916	597,348
Long-term borrowings, excluding current installments	69,782	71,103
Deferred tax liabilities	160	161
Other long-term liabilities	102,362	118,259
Total non-current liabilities	172,304	189,523
Total liabilities	837,220	786,871
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 10,000 shares authorized; none issued	—	—

and outstanding		
Class A common stock, \$0.001 par value; 500,000 shares authorized;		
130,802 and 131,784 shares issued and outstanding at September 30, 2018		
and December 31, 2017, respectively	131	132
Class B common stock, \$0.001 par value; 75,000 shares authorized;		
24,163 and 24,545 shares issued and outstanding at September 30, 2018		
and December 31, 2017, respectively	24	24
Additional paid-in capital	410,467	453,417
Accumulated other comprehensive loss	(30,133 )	(14,744 )
Retained earnings	1,643,898	1,390,235
Skechers U.S.A., Inc. equity	2,024,387	1,829,064
Non-controlling interests	142,868	119,147
Total stockholders' equity	2,167,255	1,948,211
TOTAL LIABILITIES AND EQUITY	\$3,004,475	\$2,735,082

See accompanying notes to unaudited condensed consolidated financial statements.

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

## CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net sales	\$1,176,395	\$1,094,829	\$3,561,270	\$3,193,571
Cost of sales	612,529	574,842	1,853,344	1,708,765
Gross profit	563,866	519,987	1,707,926	1,484,806
Royalty income	4,860	2,917	15,732	10,368
	568,726	522,904	1,723,658	1,495,174
Operating expenses:				
Selling	90,138	89,559	288,606	263,318
General and administrative	354,676	316,852	1,080,984	904,631
	444,814	406,411	1,369,590	1,167,949
Earnings from operations	123,912	116,493	354,068	327,225
Other income (expense):				
Interest income	3,008	780	6,280	1,574
Interest expense	(1,199 )	(1,560 )	(3,742 )	(4,895 )
Other, net	(2,849 )	2,147	(6,918 )	5,507
Total other income (expense)	(1,040 )	1,367	(4,380 )	2,186
Earnings before income tax expense	122,872	117,860	349,688	329,411
Income tax expense	16,821	11,030	45,521	42,546
Net earnings	106,051	106,830	304,167	286,865
Less: Net earnings attributable to non-controlling interests	15,323	14,520	50,504	41,025
Net earnings attributable to Skechers U.S.A., Inc.	\$90,728	\$92,310	\$253,663	\$245,840
Net earnings per share attributable to Skechers U.S.A., Inc.:				
Basic	\$0.58	\$0.59	\$1.62	\$1.58
Diluted	\$0.58	\$0.59	\$1.62	\$1.57
Weighted average shares used in calculating net earnings per				
share attributable to Skechers U.S.A., Inc.:				
Basic	155,766	155,824	156,238	155,502
Diluted	156,298	156,741	156,981	156,276

See accompanying notes to unaudited condensed consolidated financial statements.





SKECHERS U.S.A., INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF  
 COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net earnings	\$ 106,051	\$ 106,830	\$ 304,167	\$ 286,865
Other comprehensive income, net of tax:				
(Loss) gain on foreign currency translation adjustment	(8,634 )	4,713	(23,509 )	11,870
Comprehensive income	97,417	111,543	280,658	298,735
Less: Comprehensive income attributable to non-controlling				
interests	11,487	15,326	42,385	44,313
Comprehensive income attributable to Skechers U.S.A., Inc.	\$ 85,930	\$ 96,217	\$ 238,273	\$ 254,422

See accompanying notes to unaudited condensed consolidated financial statements.

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

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net earnings	\$304,167	\$286,865
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	72,896	59,576
Amortization of other assets	8,364	10,474
Provision for bad debts and returns	27,975	13,397
Non-cash share-based compensation	23,588	21,737
Deferred income taxes	1,267	(4,694 )
Loss (gain) on non-current assets	467	(1,614 )
Net foreign currency adjustments	3,222	(7,431 )
(Increase) decrease in assets:		
Receivables	(143,743 )	(164,379 )
Inventories	99,316	10,139
Prepaid expenses and other current assets	(30,856 )	(9,819 )
Other assets	(2,048 )	(7,319 )
Increase (decrease) in liabilities:		
Accounts payable	48,334	(25,118 )
Accrued expenses and other long-term liabilities	(139 )	(6,311 )
Net cash provided by operating activities	412,810	175,503
Cash flows from investing activities:		
Capital expenditures	(97,309 )	(102,163 )
Intangible asset additions	—	(134 )
Purchases of investments	(408,126 )	(1,890 )
Proceeds from sales and maturities of investments	247,158	284
Net cash used in investing activities	(258,277 )	(103,903 )
Cash flows from financing activities:		
Net proceeds from the issuances of common stock through the employee stock purchase plan	2,890	3,011
Payments on long-term debt	(1,381 )	(1,336 )
Proceeds from long-term debt	—	5,580
Proceeds from short-term borrowings	7,491	4,543
Payments for taxes related to net share settlement of equity awards	(11,402 )	—
Repurchase of Class A common stock	(58,027 )	—
Distributions to non-controlling interests of consolidated entity	(18,663 )	(9,347 )
Contributions from non-controlling interests of consolidated entity	—	46

Edgar Filing: SKECHERS USA INC - Form 10-Q

Net cash provided by (used in) financing activities	(79,092 )	2,497
Net increase in cash and cash equivalents	75,441	74,097
Effect of exchange rates on cash and cash equivalents	(9,101 )	10,299
Cash and cash equivalents at beginning of the period	736,431	718,536
Cash and cash equivalents at end of the period	\$802,771	\$802,932

Supplemental disclosures of cash flow information:

Cash paid during the period for:

Interest	\$3,585	\$4,754
Income taxes, net	72,020	48,305

See accompanying notes to unaudited condensed consolidated financial statements.

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2018 and 2017

(Unaudited)

(1) GENERAL

Basis of Presentation

The accompanying condensed consolidated financial statements of Skechers U.S.A., Inc. (the “Company”) have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”), for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S X. Accordingly, they do not include certain notes and financial presentations normally required under U.S. GAAP for complete financial reporting. The interim financial information is unaudited, but reflects all normal adjustments and accruals which are, in the opinion of management, considered necessary to provide a fair presentation for the interim periods presented. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

The results of operations for the nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2018.

Inventories

Inventories, principally finished goods, are stated at the lower of cost (based on the first-in, first-out method) or market (net realizable value). Cost includes shipping and handling fees and costs, which are subsequently expensed to cost of sales. The Company provides for estimated losses from obsolete or slow-moving inventories, and writes down the cost of inventory at the time such determinations are made. Reserves are estimated based on inventory on hand, historical sales activity, industry trends, the retail environment, and the expected net realizable value. The net realizable value is determined using estimated sales prices of similar inventory through off-price or discount store channels.

Fair Value of Financial Instruments

The accounting standard for fair value measurements provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. This accounting standard established a fair value hierarchy, which requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs required:

- Level 1 – Quoted prices in active markets for identical assets or liabilities. The Company’s Level 1 non-derivative investments primarily include money market funds, U.S. Treasury securities, and actively traded mutual funds.
- Level 2 – Observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company’s Level 2 non-derivative investments primarily include corporate notes and bonds and U.S. Agency securities. The Company

has one Level 2 derivative which is an interest rate swap related to the refinancing of its domestic distribution center (see below).

Level 3 – Inputs that are generally unobservable and typically reflect management’s estimate of assumptions that market participants would use in pricing the asset or liability. The Company currently does not have any Level 3 assets or liabilities.

The carrying amount of the Company’s financial instruments, which principally include cash and cash equivalents, short-term investments, accounts receivable, long-term investments, accounts payable and accrued expenses approximates fair value because of the relatively short maturity of such instruments. The carrying amount of the Company’s short-term and long-term borrowings, which are considered Level 2 liabilities, approximates fair value based upon current rates and terms available to the Company for similar debt.

As of August 12, 2015, the Company entered into an interest rate swap agreement concurrent with refinancing its domestic distribution center construction loan (see Note 3). The fair value of the interest rate swap was determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipt was based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. To comply with U.S. GAAP, credit valuation adjustments were incorporated to appropriately reflect both the Company's nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. The majority of the inputs used to value the interest rate swap were within Level 2 of the fair value hierarchy. As of September 30, 2018 and December 31, 2017, the interest rate swap was a Level 2 derivative and HF Logistics is responsible for any amounts related to the interest rate swap agreement.

#### Use of Estimates

The preparation of the condensed consolidated financial statements, in conformity with U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates.

#### Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09 "Revenue from Contracts with Customers," ("ASU 2014-09") which amended the FASB Accounting Standards Codification ("ASC") and created a new Topic ASC 606, "Revenue from Contracts with Customers" ("ASC 606"). This amendment prescribes that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The amendment supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition," and most industry-specific guidance throughout the Industry Topics of the Codification. For the Company's annual and interim reporting periods the mandatory adoption date of ASC 606 was January 1, 2018, and two methods of adoption were allowed, either a full retrospective adoption or a modified retrospective adoption. In August 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 to January 1, 2018. In March 2016, April 2016, May 2016, and December 2016, the FASB issued ASU 2016-08, ASU 2016-10, ASU 2016-12, and ASU 2016-20, respectively, as clarifications to ASU 2014-09. ASU 2016-08 clarifies how to identify the unit of accounting for the principal versus agent evaluation, how to apply the control principle to certain types of arrangements, such as service transactions, and reframed the indicators in the guidance to focus on evidence that an entity is acting as a principal rather than as an agent. ASU 2016-10 clarifies the existing guidance on identifying performance obligations and licensing implementation. ASU 2016-12 adds practical expedients related to the transition for contract modifications and further defines a completed contract, clarifies the objective of the collectability assessment and how revenue is recognized if collectability is not probable, and when non-cash considerations should be measured. ASU 2016-20 corrects or improves guidance in thirteen narrow focus aspects of the guidance. The effective dates for these ASUs are the same as the effective date for ASU No. 2014-09, for the Company's annual and interim periods beginning January 1, 2018. These ASU's also require enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows. The Company adopted the new revenue standard effective January 1, 2018 using the modified retrospective method. The adoption of these standards did not have a material impact on the Company's condensed consolidated financial statements.

The Company recognizes revenue when control of the promised goods or services is transferred to its customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. The Company derives income from the sale of footwear and royalties earned from licensing the Skechers brand. For North America, goods are shipped Free on Board ("FOB") shipping point directly from the Company's

domestic distribution center in Rancho Belago, California. For international wholesale customers product is shipped FOB shipping point, (i) direct from the Company's distribution center in Liege, Belgium, (ii) to third-party distribution centers in Central America, South America and Asia, (iii) directly from third-party manufacturers to our other international customers. For our distributor sales, the goods are generally delivered directly from the independent factories to third-party distribution centers or to our distributors' freight forwarders on a Free Named Carrier ("FCA") basis. The Company recognizes revenue on wholesale sales upon shipment as that is when the customer obtains control of the promised goods. Related costs paid to third-party shipping companies are recorded as cost of sales and are accounted for as a fulfillment cost and not as a separate performance obligation. The Company generates retail revenues primarily from the sale of footwear to customers at retail locations or through the Company's websites. For our in-store sales, the Company recognizes revenue at the point of sale. For sales made through our websites, we recognize revenue upon shipment to the customer which is when the customer obtains control of the promised good. Sales and value added taxes collected from e-commerce or retail customers are excluded from reported revenues.

The Company records accounts receivable at the time of shipment when the Company's right to the consideration becomes unconditional. The Company typically extends credit terms to our wholesale customers based on their creditworthiness and generally does not receive advance payments. Generally, wholesale customers do not have the right to return goods, however, the Company periodically decides to accept returns or provide customers with credits. Allowances for estimated returns, discounts, doubtful accounts and chargebacks are provided for when related revenue is recorded. Retail and e-commerce sales represent amounts due from credit card companies and are generally collected within a few days of the purchase. As such, the Company has determined that no allowance for doubtful accounts for retail and e-commerce sales is necessary.

The Company earns royalty income from its licensing arrangements which qualify as symbolic licenses rather than functional licenses. Upon signing a new licensing agreement, we receive up-front fees, which are generally characterized as prepaid royalties. These fees are initially deferred and recognized as revenue is earned (i.e., as licensed sales are reported to the Company or on a straight-line basis over the term of the agreement). The first calculated royalty payment is based on actual sales of the licensed product or, in some cases, minimum royalty payments. The Company calculates and accrues estimated royalties based on the agreement terms and correspondence with the licensees regarding actual sales.

#### Judgments

The Company considered several factors in determining that control transfers to the customer upon shipment of products. These factors include that legal title transfers to the customer, the Company has a present right to payment, and the customer has assumed the risks and rewards of ownership at the time of shipment. The Company accrues a reserve for product returns at the time of sale based on our historical experience. The Company also accrues amounts for goods expected to be returned in salable condition. As of September 30, 2018 and December 31, 2017, the Company's sales returns reserve totaled \$42.6 million and \$43.4 million, respectively, and was included in accrued expenses and accounts receivable in the condensed consolidated balance sheets, respectively.

#### Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02 "Leases (Topic 842)," ("ASU 2016-02"). ASU 2016-02 is intended to increase transparency and comparability among organizations relating to leases. Lessees will be required to recognize a liability to make lease payments and a right-of-use asset representing the right to use the underlying asset for the lease term. The FASB retained a dual model for lease classification, requiring leases to be classified as finance or operating leases to determine recognition in the earnings statement and cash flows; however, substantially all leases will be required to be recognized on the balance sheet. The standards update will also require quantitative and qualitative disclosures regarding key information about leasing arrangements. The standards update is effective using a modified retrospective approach for fiscal years and interim periods beginning after December 15, 2018, with early adoption permitted. The Company will adopt the standard on January 1, 2019. As originally issued, the standards update requires application at the beginning of the earliest comparative period presented at the time of adoption. In July 2018, the FASB issued ASU No. 2018-10, "Codification Improvements to Topic 842, Leases," ("ASU 2018-10"). This ASU makes various targeted amendments to the leasing standard and the Company is evaluating this ASU in connection with adoption of the standard. In July 2018, the FASB issued ASU 2018-11, "Leases (Topic 842): Targeted Improvements," ("ASU No. 2018-11"). This standard allows entities to initially apply the new leases standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The standard also provides for certain practical expedients. The Company plans to elect this optional transition method. The Company is still assessing the impact of the new standard on its consolidated financial statements and its internal controls process, but anticipates a material increase in assets and liabilities due to the



recognition of the required right-of-use asset and corresponding liability for all lease obligations that are currently classified as operating leases, such as real estate leases for corporate headquarters, administrative offices, retail stores, showrooms, and distribution facilities, as well as additional disclosure on all of the Company's lease obligations. The earnings statement recognition of lease expense is expected to be similar to the Company's current methodology.

In February 2018, the FASB issued ASU No. 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," ("ASU 2018-02"). The standard permits a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. ASU 2018-02 is effective for the Company's annual and interim reporting periods beginning December 15, 2018, with early adoption permitted. The Company is currently evaluating the impact of ASU 2018-02; however, at the current time the Company does not expect that the adoption of this ASU will have a material impact on its condensed consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13 "Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement," ("ASU No. 2018-13"), which modifies the disclosure requirements on fair value measurements, including the consideration of costs and benefits. ASU 2018-13 is effective for all entities for fiscal years

beginning after December 15, 2019, but entities are permitted to early adopt either the entire standard or only the provisions that eliminate or modify the requirements. The Company is currently evaluating the impact of ASU 2018-13; however, at the current time the Company does not expect that the adoption of this ASU will have a material impact on its condensed consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-15 “Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract,” (“ASU 2018-15”). ASU 2018-15 requires that issuers follow the internal-use software guidance in Accounting Standards Codification (ASC) 350-40 to determine which costs to capitalize as assets or expense as incurred. The ASC 350-40 guidance requires that certain costs incurred during the application development stage be capitalized and other costs incurred during the preliminary project and post-implementation stages be expensed as they are incurred. ASU 2018-15 is effective for fiscal years beginning after December 15, 2019. The Company is currently evaluating the impact of ASU 2018-15; however, at the current time the Company does not expect that the adoption of this ASU will have a material impact on its condensed consolidated financial statements.

## (2) CASH, CASH EQUIVALENTS, SHORT-TERM AND LONG-TERM INVESTMENTS

The Company’s investments consists of mutual funds held in the company’s deferred compensation plan and classified as trading securities, U.S. Treasury securities, corporate notes and bonds and U.S. Agency securities, that the Company has the intent and ability to hold to maturity and therefore, are classified as held-to-maturity. The following tables show the Company’s cash, cash equivalents, short-term and long-term investments by significant investment category as of September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018			Fair Value	Cash and Cash Equivalents	Short-Term Investments	Long-Term Investments
	Adjusted Cost	Unrealized Gains	Unrealized Losses				
Cash	\$628,753	\$ -	\$ -	\$628,753	\$ 628,753	\$ -	\$ -
Level 1:							
Money market funds	159,815	-	-	159,815	159,815	-	-
U.S. Treasury securities	14,203	-	-	14,203	14,203	-	-
Mutual funds	21,308	-	-	21,308	-	-	21,308
Total level 1	195,326	-	-	195,326	174,018	-	21,308
Level 2:							
Corporate notes and bonds	150,776	-	-	150,776	-	85,227	65,549
U.S. Agency securities	6,279	-	-	6,279	-	2,050	4,229
Total level 2	157,055	-	-	157,055	-	87,277	69,778
<b>TOTAL</b>	<b>\$981,134</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$981,134</b>	<b>\$ 802,771</b>	<b>\$ 87,277</b>	<b>\$ 91,086</b>

## December 31, 2017

	Adjusted Cost	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash	Short-Term Investments	Long-Term Investments
--	---------------	------------------	-------------------	------------	---------------	------------------------	-----------------------

Edgar Filing: SKECHERS USA INC - Form 10-Q

				Value	Equivalents		
Cash	\$736,431	\$ -	\$ -	\$736,431	\$736,431	\$ -	\$ -
Level 1:							
Mutual funds	17,396	-	-	17,396	-	-	17,396
TOTAL	\$753,827	\$ -	\$ -	\$753,827	\$736,431	\$ -	\$ 17,396

The Company may sell certain of its investments prior to their stated maturities for strategic reasons including, but not limited to, anticipation of credit deterioration and duration management. The maturities of the Company's long-term investments are typically less than two years.

The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. The Company typically invests in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy generally requires investments to be investment grade, with the primary objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates and the Company's intent to sell, or whether it is more likely than not it will be required to sell the investment before recovery of the investment's cost basis. As of September 30, 2018, the Company does not consider any of its investments to be other-than-temporarily impaired.

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

The Company had \$2.9 million and \$4.4 million of outstanding letters of credit as of September 30, 2018 and December 31, 2017, respectively, and approximately \$12.7 million and \$8.0 million in short-term borrowings as of September 30, 2018 and December 31, 2017, respectively.

Long-term borrowings at September 30, 2018 and December 31, 2017 are as follows (in thousands):

	2018	2017
Note payable to banks, due in monthly installments of \$348 (includes principal and interest), variable-rate interest at 4.24% per annum, secured by property, balloon payment of \$62,843 due August 2020	\$65,511	\$66,604
Note payable to Luen Thai Enterprise, Ltd., balloon payment of \$5,725 due January 2021	5,725	5,745
Note payable to TCF Equipment Finance, Inc., due in monthly installments of \$31 (includes principal and interest), fixed- rate interest at 5.24% per annum, due July 2019	298	555
Loan payable to a bank, variable-rate interest only at 4.28% per annum, due September 2023	2,829	—
<b>Subtotal</b>	<b>74,363</b>	<b>72,904</b>
<b>Less current installments</b>	<b>4,581</b>	<b>1,801</b>
<b>Total long-term borrowings</b>	<b>\$69,782</b>	<b>\$71,103</b>

The Company's long-term debt obligations contain both financial and non-financial covenants, including cross-default provisions. The Company is in compliance with the covenants of its long-term borrowings as of September 30, 2018.

On September 29, 2018, through a subsidiary of the Company's Chinese joint venture ("the Subsidiary"), the Company entered into a 700 million yuan loan agreement with China Construction Bank Corporation ("the China DC Loan Agreement"). The proceeds from the China DC Loan Agreement will be used to finance the construction of the Company's distribution center in China. Interest will be paid quarterly. The interest rate will float and be calculated at a reference rate provided by the People's Bank of China. The interest rate may increase or decrease over the life of the loan, and will be evaluated every 12 months. The principal of the loan will be repaid in semi-annual installments, beginning in 2021, of variable amounts as specified in the China DC Loan Agreement. The China DC Loan Agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including covenants that limit the ability of the Subsidiary to, among other things, allow external investment to be added, pledge

assets, issue debt with priority over the China DC Loan Agreement, and adjust the capital stock structure of the Subsidiary. The China DC Loan Agreement matures on September 28, 2023. The obligations of the Subsidiary under the China DC Loan Agreement are jointly and severally guaranteed by the Company's Chinese joint venture. As of September 30, 2018 there was \$2.8 million outstanding under this credit facility, which is classified as short-term borrowings in the Company's condensed consolidated balance sheets.

On June 30, 2015, the Company entered into a \$250.0 million loan and security agreement, subject to increase by up to \$100.0 million, (the "Credit Agreement"), with the following lenders: Bank of America, N.A., MUFG Union Bank, N.A. and HSBC Bank USA, National Association. The Credit Agreement matures on June 30, 2020. The Credit Agreement replaces the credit agreement dated June 30, 2009, which expired on June 30, 2015. The Credit Agreement permits the Company and certain of its subsidiaries to borrow based on a percentage of eligible accounts receivable plus the sum of (a) the lesser of (i) a percentage of eligible inventory to be sold at wholesale and (ii) a percentage of net orderly liquidation value of eligible inventory to be sold at wholesale, plus (b) the lesser of (i) a percentage of the value of eligible inventory to be sold at retail and (ii) a percentage of net orderly liquidation value of eligible inventory to be sold at retail, plus (c) the lesser of (i) a percentage of the value of eligible in-transit inventory and (ii) a percentage of the net orderly liquidation value of eligible in-transit inventory. Borrowings bear interest at the Company's election based on (a) LIBOR or (b) the greater of (i) the Prime Rate, (ii) the Federal Funds Rate plus 0.5% and (iii) LIBOR for a 30-day period plus 1.0%, in each case, plus an applicable margin based on the average daily principal balance of revolving loans available under the Credit Agreement. The Company pays a monthly unused line of credit fee of 0.25%, payable on the first day of each month in arrears, which is based on the average daily principal balance of outstanding revolving loans and undrawn amounts of letters of credit outstanding during such month. The Credit Agreement further provides for a limit on the issuance of letters of credit to a maximum of \$100.0 million. The Credit Agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including covenants that will limit the ability of the Company and its subsidiaries to, among other things, incur debt, grant liens, make certain acquisitions, dispose of assets, effect a change of control of the Company, make certain

restricted payments including certain dividends and stock redemptions, make certain investments or loans, enter into certain transactions with affiliates and certain prohibited uses of proceeds. The Credit Agreement also requires compliance with a minimum fixed-charge coverage ratio if Availability drops below 10% of the Revolver Commitments (as such terms are defined in the Credit Agreement) until the date when no event of default has existed and Availability has been over 10% for 30 consecutive days. The Company paid closing and arrangement fees of \$1.1 million on this facility which are included in other assets in the condensed consolidated balance sheets, and are being amortized to interest expense over the five-year life of the facility. As of September 30, 2018 and December 31, 2017, there was \$0.1 million outstanding under the Company's credit facilities, classified as short-term borrowings in the Company's condensed consolidated balance sheets. The remaining balance in short-term borrowings, as of September 30, 2018, is related to the Company's international operations.

On April 30, 2010, HF Logistics-SKX, LLC (the "JV"), through its subsidiary HF-T1, entered into a construction loan agreement with Bank of America, N.A., as administrative agent and as a lender, and Raymond James Bank, FSB, as a lender (collectively, the "Construction Loan Agreement"), pursuant to which the JV obtained a loan of up to \$55.0 million used for construction of the project on certain property (the "Original Loan"). On November 16, 2012, HF-T1 executed a modification to the Construction Loan Agreement (the "Modification"), which added OneWest Bank, FSB as a lender, and increased the borrowings under the Original Loan to \$80.0 million and extended the maturity date of the Original Loan to October 30, 2015. On August 11, 2015, the JV, through HF-T1, entered into an amended and restated loan agreement with Bank of America, N.A., as administrative agent and as a lender, and CIT Bank, N.A. (formerly known as OneWest Bank, FSB) and Raymond James Bank, N.A., as lenders (collectively, the "Amended Loan Agreement"), which amends and restates in its entirety the Construction Loan Agreement and the Modification.

As of the date of the Amended Loan Agreement, the outstanding principal balance of the Original Loan was \$77.3 million. In connection with this refinancing of the Original Loan, the JV, the Company and its joint-venture partner HF Logistics ("HF") agreed that the Company would make an additional capital contribution of \$38.7 million to the JV, through HF-T1, to make a prepayment on the Original Loan based on the Company's 50% equity interest in the JV. The prepayment equaled the Company's 50% share of the outstanding principal balance of the Original Loan. Under the Amended Loan Agreement, the parties agreed that the lenders would loan \$70.0 million to HF-T1 (the "New Loan"). The New Loan was used by the JV, through HF-T1, to (i) refinance all amounts owed on the Original Loan after taking into account the prepayment described above, (ii) pay \$0.9 million in accrued interest, loan fees and other closing costs associated with the New Loan and (iii) make a distribution of \$31.3 million less the amounts described in clause (ii) to HF. Pursuant to the Amended Loan Agreement, the interest rate on the New Loan is the LIBOR Daily Floating Rate (as defined in the Amended Loan Agreement) plus a margin of 2%. The maturity date of the New Loan is August 12, 2020, which HF-T1 has one option to extend by an additional 24 months, or until August 12, 2022, upon payment of a fee and satisfaction of certain customary conditions. On August 11, 2015, HF-T1 and Bank of America, N.A. entered into an ISDA Master Agreement (together with the schedule related thereto, the "Swap Agreement") to govern derivative and/or hedging transactions that HF-T1 concurrently entered into with Bank of America, N.A. Pursuant to the Swap Agreement, on August 14, 2015, HF-T1 entered into a confirmation of swap transactions (the "Interest Rate Swap") with Bank of America, N.A. The Interest Rate Swap has an effective date of August 12, 2015 and a maturity date of August 12, 2022, subject to early termination at the option of HF-T1, commencing on August 1, 2020. The Interest Rate Swap fixes the effective interest rate of the New Loan at 4.08% per annum. Pursuant to the terms of the JV, HF is responsible for the related interest expense payments on the New Loan, and any amounts related to the Swap Agreement. The full amount of interest expense paid related to the New Loan has been included in non-controlling interests in the condensed consolidated balance sheets. The Amended Loan Agreement and the Swap Agreement are subject to customary covenants and events of default. Bank of America, N.A. also acts as a lender and syndication agent under the Credit Agreement dated June 30, 2015.

#### (4) NON-CONTROLLING INTERESTS

The Company has equity interests in several joint ventures that were established either to exclusively distribute the Company's products or to construct the Company's domestic distribution facility. These joint ventures are variable interest entities ("VIEs") under ASC 810-10-15-14. The Company's determination of the primary beneficiary of a VIE considers all relationships between the Company and the VIE, including management agreements, governance documents and other contractual arrangements. The Company has determined for its VIEs that the Company is the primary beneficiary because it has both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Accordingly, the Company includes the assets and liabilities and results of operations of these entities in its condensed consolidated financial statements, even though the Company may not hold a majority equity interest. There have been no changes during 2018 in the accounting treatment or characterization of any previously identified VIE. The Company continues to reassess these relationships quarterly. The assets of these joint ventures are restricted in that they are not available for general business use outside the context of such joint ventures. The holders of the liabilities of each joint venture have no recourse to the Company. The Company does not have a variable interest in any unconsolidated VIEs.

The following VIEs are consolidated into the Company's condensed consolidated financial statements and the carrying amounts and classification of assets and liabilities were as follows (in thousands):

	September 30, 2018	December 31, 2017
HF Logistics-SKX, LLC		
Current assets	\$ 2,629	\$ 1,540
Non-current assets	99,463	103,407
Total assets	\$ 102,092	\$ 104,947
Current liabilities	\$ 3,196	\$ 2,718
Non-current liabilities	65,065	66,367
Total liabilities	\$ 68,261	\$ 69,085
	September 30, 2018	December 31, 2017
Distribution joint ventures <sup>(1)</sup>		
Current assets	\$ 504,470	\$ 389,687
Non-current assets	101,292	90,972
Total assets	\$ 605,762	\$ 480,659
Current liabilities	\$ 268,543	\$ 188,700
Non-current liabilities	4,453	9,201
Total liabilities	\$ 272,996	\$ 197,901

<sup>(1)</sup>Distribution joint ventures include Skechers Footwear Ltd. (Israel), Skechers China Limited, Skechers Korea Limited, Skechers Southeast Asia Limited, Skechers (Thailand) Limited, Skechers Retail India Private Limited, and Skechers South Asia Private Limited.

The following is a summary of net earnings attributable to, distributions to and contributions from non-controlling interests (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Net earnings attributable to non-controlling interests	\$ 15,323	\$ 14,520	\$ 50,504	\$ 41,025
Distributions to:				
HF Logistics-SKX, LLC	1,085	1,048	3,292	3,091
Skechers China Limited	7,270	—	12,660	4,710
Skechers Retail India Private Limited	—	—	68	—
Skechers Southeast Asia Limited	2,025	1,347	2,025	1,347
Skechers Hong Kong Limited	618	199	618	199
Contributions from:				
Skechers Footwear Ltd. (Israel)	—	—	—	46



(5) STOCKHOLDERS' EQUITY

During the three months ended September 30, 2018, no shares of Class B Common stock were converted into shares of Class A common stock. During the nine months ended September 30, 2018, 381,876 shares of Class B common stock were converted into shares of Class A common stock. During the three and nine months ended September 30, 2017, no shares of Class B common stock were converted into shares of Class A common stock.

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

	Nine Months Ended	
	September 30, 2018	2017
Non-controlling interests, beginning of period	\$ 119,147	\$ 81,881
Net earnings	50,504	41,025
Foreign currency translation adjustment	(8,120 )	3,288
Capital contributions	—	46
Capital distributions	(18,663 )	(9,347 )
Non-controlling interests, end of period	\$ 142,868	\$ 116,893

#### (6) SHARE REPURCHASE PROGRAM

On February 6, 2018, the Company's Board of Directors authorized a share repurchase program (the "Share Repurchase Program"), pursuant to which the Company may, from time to time, purchase shares of its Class A common stock, par value \$0.001 per share ("Class A common stock"), for an aggregate repurchase price not to exceed \$150.0 million. As of September 30, 2018, there was \$92.0 million remaining to repurchase shares under the Share Repurchase Program. The Share Repurchase Program expires on February 6, 2021. Share repurchases may be executed through various means, including, without limitation, open market transactions, privately negotiated transactions or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Act of 1934, as amended, subject to market conditions, applicable legal requirements and other relevant factors. The Share Repurchase Program does not obligate the Company to acquire any particular amount of shares of Class A common stock and the program may be suspended or discontinued at any time.

The following table provides a summary of the Company's stock repurchase activities during the three and nine months ended September 30, 2018:

	Three months ended September 30, 2018	Nine months ended September 30, 2018
Shares repurchased	1,406,591	1,993,163
Average cost per share	\$28.46	\$29.11
Total cost of shares repurchased (in thousands):	\$40,028	\$58,027

#### (7) EARNINGS PER SHARE

Basic earnings per share represent net earnings divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share, in addition to the weighted average determined for basic earnings per share, includes potential dilutive common shares using the treasury stock method.

The Company has two classes of issued and outstanding common stock: Class A Common Stock and Class B Common Stock. Holders of Class A Common Stock and holders of Class B Common Stock have substantially identical rights, including rights with respect to any declared dividends or distributions of cash or property and the right to receive proceeds on liquidation or dissolution of the Company after payment of the Company's indebtedness. The two classes have different voting rights, with holders of Class A Common Stock entitled to one vote per share while holders of Class B Common Stock are entitled to ten votes per share on all matters submitted to a vote of stockholders. The Company uses the two-class method for calculating net earnings per share. Basic and diluted net earnings per share of Class A Common Stock and Class B Common Stock are identical. The shares of Class B Common Stock are convertible at any time at the option of the holder into shares of Class A Common Stock on a share-for-share basis. In addition, shares of Class B Common Stock will be automatically converted into a like number of shares of Class A Common Stock upon transfer to any person or entity who is not a permitted transferee.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Basic earnings per share				
Net earnings attributable to Skechers U.S.A., Inc.	\$90,728	\$92,310	\$253,663	\$245,840
Weighted average common shares outstanding	155,766	155,824	156,238	155,502
Basic earnings per share attributable to				
Skechers U.S.A., Inc.	\$0.58	\$0.59	\$1.62	\$1.58

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

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Diluted earnings per share				
Net earnings attributable to Skechers U.S.A., Inc.	\$90,728	\$92,310	\$253,663	\$245,840
Weighted average common shares outstanding	155,766	155,824	156,238	155,502
Dilutive effect of nonvested shares	532	917	743	774
Weighted average common shares outstanding	156,298	156,741	156,981	156,276
Diluted earnings per share attributable to				
Skechers U.S.A., Inc.	\$0.58	\$0.59	\$1.62	\$1.57

There were 407,267 and 335,885 shares excluded from the computation of diluted earnings per share for the three and nine months ended September 30, 2018 because they are antidilutive. There were 25,556 and 51,470 shares excluded from the computation of diluted earnings per share for the three and nine months ended September 30, 2017 because they are antidilutive.

## (8) STOCK COMPENSATION

### (a) Incentive Award Plan

On April 17, 2017, the Company's Board of Directors adopted the 2017 Incentive Award Plan (the "2017 Plan"), which became effective upon approval by the Company's stockholders on May 23, 2017. The 2017 Plan replaced and superseded in its entirety the 2007 Incentive Award Plan (the "2007 Plan"), which expired pursuant to its terms on May 24, 2017. A total of 10,000,000 shares of Class A Common Stock are reserved for issuance under the 2017 Plan, which provides for grants of ISOs, non-qualified stock options, restricted stock and various other types of equity awards as described in the plan to the employees, consultants and directors of the Company and its subsidiaries. The

2017 Plan is administered by the Company's Board of Directors with respect to awards to non-employee directors and by the Company's Compensation Committee with respect to other eligible participants.

For stock-based awards, the Company recognized compensation expense based on the grant date fair value. Share based compensation expense was \$7.6 million and \$7.5 million for the three months ended September 30, 2018 and 2017, respectively. Share-based compensation expense was \$23.6 million and \$21.7 million for the nine months ended September 30, 2018 and 2017, respectively. During the three and nine months ended September 30, 2018, the Company redeemed 7,899 and 308,155 shares of Class A Common Stock for \$0.2 million and \$11.4 million to satisfy employee tax withholding requirements. No shares were redeemed during the three and nine months ended September 30, 2017.

A summary of the status and changes of the Company's nonvested shares related to the 2007 Plan and the 2017 Plan, as of and for the nine months ended September 30, 2018 is presented below:

	Shares	Weighted Average Grant-Date Fair Value
Nonvested at December 31, 2017	2,303,557	\$ 26.25
Granted	1,798,500	38.14
Vested	(820,283 )	22.63
Cancelled	(121,333 )	29.56
Nonvested at September 30, 2018	3,160,441	33.82

As of September 30, 2018, there was \$82.4 million of unrecognized compensation cost related to nonvested common shares. The cost is expected to be amortized over a weighted average period of 2.8 years.

(b) Stock Purchase Plan

On April 17, 2017, the Company's Board of Directors adopted the 2018 Employee Stock Purchase Plan (the "2018 ESPP"), which the Company's stockholders approved on May 23, 2017. The 2018 Employee Stock Purchase Plan provides eligible employees of the Company and its subsidiaries with the opportunity to purchase shares of the Company's Class A Common Stock at a purchase price equal to 85% of the Class A Common Stock's fair market value on the first trading day or last trading day of each purchase period, whichever is lower. The 2018 ESPP generally provides for two six-month purchase periods every twelve months: June 1 through November 30 and December 1 through May 31, except that the initial purchase period under the 2018 ESPP had a duration of five months, commencing on January 1, 2018 and ending on May 31, 2018. Eligible employees participating in the 2018 ESPP will, for a purchase period, be able to invest up to 15% of their compensation through payroll deductions during each purchase period. A total of 5,000,000 shares of Class A Common Stock are available for issuance under the 2018 ESPP.

(9) INCOME TAXES

Income tax expense and the effective tax rate for the three and nine months ended September 30, 2018 and 2017 were as follows (dollar amounts in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Income tax expense	\$ 16,821	\$ 11,030	\$ 45,521	\$ 42,546
Effective tax rate	13.7 %	9.4 %	13.0 %	12.9 %

The tax provisions for the three and nine months ended September 30, 2018 and 2017 were computed using the estimated effective tax rates applicable to each of the domestic and international taxable jurisdictions for the full year. The Company estimates its effective tax rate to be between 13% to 15% for 2018, which implies a fourth quarter effective tax rate of between 17% and 20%. The Company's tax rate is subject to management's quarterly review and revision, as necessary.

The Company's provision for income tax expense and effective income tax rate are significantly impacted by the mix of the Company's domestic and foreign earnings (loss) before income taxes. In the foreign jurisdictions in which the Company has operations, the applicable statutory rates range from 0% to 34%, which is on average significantly lower than the U.S. federal and state combined statutory rate of approximately 26%. Due to the enactment of Tax Cuts and Jobs Act ("the Tax Act") in December 2017, the Company is subject to a tax on global intangible low-taxed income ("GILTI"). GILTI is a tax on foreign income in excess of a deemed return on tangible assets of foreign corporations. Companies subject to GILTI have the option to account for the GILTI tax as a period cost if and when incurred, or to recognize deferred taxes for temporary differences including outside basis differences expected to reverse as GILTI. The Company has elected to account for GILTI as a period cost, and therefore has included GILTI expense in its effective tax rate calculation for the three and nine months ended September 30, 2018.

The U.S. Securities and Exchange Commission (“SEC”) staff issued Staff Accounting Bulletin 118, (“SAB 118”), which provides guidance on accounting for certain tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under Accounting Standards Codification 740 (“ASC 740”). For the nine months ended September 30, 2018, the Company obtained additional information which reduced the Company’s provisional accounting for certain tax effects of the Tax Act by \$10.9 million, from \$99.9 million as reported at December 31, 2017, to \$89.0 million at September 30, 2018. Any subsequent adjustment to certain accounting for the tax effects of the Tax Act will be recorded to current tax expense during the quarter of 2018 when the analysis is completed.

For both the three months and nine months ended September 30, 2018, the increase in the effective tax rate was due to increased U.S. tax on foreign earnings resulting from changes in U.S. tax law under the Tax Act.

As of September 30, 2018, the Company had approximately \$802.8 million in cash and cash equivalents, of which \$405.0 million, or 50.5%, was held outside the U.S. Of the \$405.0 million held by the Company’s non-U.S. subsidiaries, approximately \$235.3 million is available for repatriation to the U.S. without incurring U.S. income taxes and applicable non-U.S. income and withholding taxes in excess of the amounts accrued in the Company’s condensed consolidated financial statements as of September 30, 2018.

The Company’s cash and cash equivalents held in the U.S. and cash provided from operations are sufficient to meet the Company’s liquidity needs in the U.S. for the next twelve months. However, in anticipation of the needs of the Company’s share repurchase program and the need to provide payment of the Company’s provisional Transition Tax liability, the Company may repatriate certain funds held outside the U.S. for which all applicable U.S. and non-U.S. tax has been fully provided as of September 30, 2018. Because of the need for cash for operating capital and continued overseas expansion, the Company also does not foresee the need for any of its foreign subsidiaries to distribute funds up to an intermediate foreign parent company in any form of taxable dividend. Under current applicable tax laws, if the Company chooses to repatriate some or all of the funds the Company has designated as indefinitely reinvested outside the U.S., the amount repatriated would not be subject to U.S. income taxes but may be subject to applicable non-U.S. income and withholding taxes.

In October 2016, the FASB issued ASU No. 2016-16, “Accounting for Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory” (“ASU 2016-16”). The standard requires that the income tax impact of intra-entity sales and transfers of property, except for inventory, be recognized when the transfer occurs. The standard will require any deferred taxes not yet recognized on intra entity transfers to be recorded to retained earnings under a modified retrospective approach. Early adoption is permitted. Effective January 1, 2018, the Company adopted ASU 2016-16. The adoption of ASU 2016-16 did not have a material impact on its condensed consolidated financial statements.

#### (10) BUSINESS AND CREDIT CONCENTRATIONS

The Company generates sales in the United States; however, several of its products are sold into various foreign countries, which subjects the Company to the risks of doing business abroad. In addition, the Company operates in the footwear industry, and its business depends on the general economic environment and levels of consumer spending. Changes in the marketplace may significantly affect management’s estimates and the Company’s performance. Management performs regular evaluations concerning the ability of customers to satisfy their obligations and provides for estimated doubtful accounts. Domestic accounts receivable, which generally do not require collateral from customers, were \$204.2 million and \$206.1 million before allowances for bad debts, sales returns and chargebacks at September 30, 2018 and December 31, 2017, respectively. Foreign accounts receivable, which in some cases are collateralized by letters of credit, were \$325.3 million and \$251.0 million before allowance for bad debts, sales returns and chargebacks at September 30, 2018 and December 31, 2017, respectively. The Company’s credit losses attributable to write-offs for the three months ended September 30, 2018 and 2017 were \$2.2 million and \$5.7 million,



respectively. The Company's credit losses attributable to write-offs for the nine months ended September 30, 2018 and 2017 were \$6.4 million and \$7.9 million, respectively.

Assets located outside the U.S. consist primarily of cash, accounts receivable, inventory, property, plant and equipment, and other assets. Net assets held outside the United States were \$1.443 billion and \$1.273 billion at September 30, 2018 and December 31, 2017, respectively.

The Company's net sales to its five largest customers accounted for approximately 10.6% and 11.4% of total net sales for the three months ended September 30, 2018 and 2017, respectively. The Company's net sales to its five largest customers accounted for approximately 10.5% and 12.5% of total net sales for the nine months ended September 30, 2018 and 2017, respectively.

The Company's top five manufacturers produced the following, as a percentage of total production, for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
Manufacturer #1	11.1 %	17.0 %	11.3 %	19.8 %
Manufacturer #2	10.1 %	10.4 %	10.7 %	10.8 %
Manufacturer #3	6.8 %	9.8 %	9.1 %	9.0 %
Manufacturer #4	6.7 %	5.6 %	5.4 %	5.9 %
Manufacturer #5	5.6 %	5.1 %	5.4 %	4.3 %
	40.3 %	47.9 %	41.9 %	49.8 %

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

#### (11) SEGMENT AND GEOGRAPHIC REPORTING

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net sales:				
Domestic wholesale	\$285,406	\$294,127	\$991,658	\$993,664
International wholesale	531,123	475,177	1,573,955	1,323,688
Retail	359,866	325,525	995,657	876,219
Total	\$1,176,395	\$1,094,829	\$3,561,270	\$3,193,571

Three Months Ended    Nine Months Ended

Edgar Filing: SKECHERS USA INC - Form 10-Q

	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
<b>Gross profit:</b>				
Domestic wholesale	\$ 110,572	\$ 110,693	\$ 372,166	\$ 376,502
International wholesale	240,056	219,260	752,336	594,898
Retail	213,238	190,034	583,424	513,406
<b>Total</b>	<b>\$ 563,866</b>	<b>\$ 519,987</b>	<b>\$ 1,707,926</b>	<b>\$ 1,484,806</b>

	September 30, 2018	December 31, 2017
<b>Identifiable assets:</b>		
Domestic wholesale	\$ 1,340,561	\$ 1,259,119
International wholesale	1,262,200	1,116,928
Retail	401,714	359,035
<b>Total</b>	<b>\$ 3,004,475</b>	<b>\$ 2,735,082</b>

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
<b>Additions to property, plant and equipment:</b>				
Domestic wholesale	\$10,654	\$5,418	\$28,320	\$8,699
International wholesale	13,711	14,461	31,118	45,884
Retail	12,126	5,782	37,871	47,580
<b>Total</b>	<b>\$36,491</b>	<b>\$25,661</b>	<b>\$97,309</b>	<b>\$102,163</b>

#### Geographic Information:

The following summarizes the Company's operations in different geographic areas for the periods indicated (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
<b>Net Sales <sup>(1)</sup>:</b>				
United States	\$523,281	\$514,235	\$1,648,642	\$1,595,078
Canada	44,646	46,979	146,080	133,362
Other international <sup>(2)</sup>	608,468	533,615	1,766,548	1,465,131
<b>Total</b>	<b>\$1,176,395</b>	<b>\$1,094,829</b>	<b>\$3,561,270</b>	<b>\$3,193,571</b>

	September 30, 2018	December 31, 2017
<b>Property, plant and equipment, net:</b>		
United States	\$392,891	\$382,426
Canada	9,730	9,888
Other international <sup>(2)</sup>	162,774	149,287
<b>Total</b>	<b>\$565,395</b>	<b>\$541,601</b>

<sup>(1)</sup>The Company has subsidiaries in Asia, Central America, Europe, the Middle East, North America, and South America that generate net sales within those respective regions and in some cases the neighboring regions. The Company has joint ventures in Asia that generate net sales from those regions. The Company also has a subsidiary in Switzerland that generates net sales from that country in addition to net sales to distributors located in numerous non-European countries. External net sales are attributable to geographic regions based on the location of each of the Company's subsidiaries. A subsidiary may earn revenue from external net sales and external royalties, or from inter-subsiary net sales, royalties, fees and commissions provided in accordance with certain inter-subsiary agreements. The resulting earnings of each subsidiary in its respective country are recognized under each respective

country's tax code. Inter-subsidary revenues and expenses subsequently are eliminated in the Company's condensed consolidated financial statements and are not included as part of the external net sales reported in different geographic areas.

<sup>(2)</sup>Other international includes Asia, Central America, Europe, the Middle East, and South America.

In response to the State Department's trade restrictions with Sudan and Syria, we do not authorize or permit any distribution or sales of our product in these countries, and we are not aware of any current or past distribution or sales of our product in Sudan or Syria.

(12)RELATED PARTY TRANSACTIONS

On July 29, 2010, the Company formed the Skechers Foundation (the "Foundation"), which is a 501(c)(3) non-profit entity that does not have any shareholders or members. The Foundation is not a subsidiary of, and is not otherwise affiliated with the Company, and the Company does not have a financial interest in the Foundation. However, two officers and directors of the Company, Michael Greenberg, the Company's President, and David Weinberg, the Company's Chief Operating Officer, are also officers and directors of the Foundation. During the three months ended September 30, 2018 and 2017, the Company made contributions of \$251,000 and \$250,000 respectively, to the Foundation. During the nine months ended September 30, 2018 and 2017, the Company made contributions of \$751,000 and \$750,000 to the Foundation respectively.

(13)LITIGATION

In accordance with U.S. GAAP, the Company records a liability in its condensed consolidated financial statements for loss contingencies when a loss is known or considered probable and the amount can be reasonably estimated. When determining the estimated loss or range of loss, significant judgment is required to estimate the amount and timing of a loss to be recorded. Estimates of probable losses resulting from litigation and governmental proceedings are inherently difficult to predict, particularly when the matters are in the procedural stages or with unspecified or indeterminate claims for damages, potential penalties, or fines. Accordingly, the Company cannot determine the final amount, if any, of its liability beyond the amount accrued in the condensed consolidated financial statements as of September 30, 2018, nor is it possible to estimate what litigation-related costs will be in the future; however, the Company believes that the likelihood that claims related to litigation would result in a material loss to the Company, either individually or in the aggregate, is remote.

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

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and Notes thereto in Item 1 of this report and our annual report on Form 10-K for the year ended December 31, 2017.

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

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

- global economic, political and market conditions including the challenging consumer retail market in the United States;
- our ability to maintain our brand image and to anticipate, forecast, identify, and respond to changes in fashion trends, consumer demand for the products and other market factors;
- our ability to remain competitive among sellers of footwear for consumers, including in the highly competitive performance footwear market;
- our ability to sustain, manage and forecast our costs and proper inventory levels;
- the loss of any significant customers, decreased demand by industry retailers and the cancellation of order commitments;
- our ability to continue to manufacture and ship our products that are sourced in China and Vietnam, which could be adversely affected by various economic, political or trade conditions, or a natural disaster in China or Vietnam;
- our ability to predict our revenues, which have varied significantly in the past and can be expected to fluctuate in the future due to a number of reasons, many of which are beyond our control;
- sales levels during the spring, back-to-school and holiday selling seasons; and
- other factors referenced or incorporated by reference in our annual report on Form 10-K for the year ended December 31, 2017 under the captions "Item 1A: Risk Factors" and "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations."

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

FINANCIAL OVERVIEW

Our net sales for the three months ended September 30, 2018 were \$1.176 billion, an increase of \$81.6 million, or 7.5%, as compared to net sales of \$1.095 billion for the three months ended September 30, 2017. This increase was primarily attributable to increased sales from our international wholesale and global retail businesses, and was partially offset by a decrease in our domestic wholesale segment. Gross margins increased to 47.9% for the three months ended September 30, 2018 from 47.5% for the same period in the prior year primarily due to higher domestic wholesale and retail gross margins. Net earnings attributable to Skechers U.S.A., Inc. were \$90.7 million for the three months ended September 30, 2018, a decrease of \$1.6 million, or 1.7%, compared to net earnings of \$92.3 million in the prior-year period. Diluted net earnings per share attributable to Skechers U.S.A., Inc. for the three



months ended September 30, 2018 were \$0.58, which reflected a 1.7% decrease from the \$0.59 diluted net earnings per share reported in the same prior-year period. The decrease in net earnings and diluted net earnings per share attributable to Skechers U.S.A., Inc. for the three months ended September 30, 2018 was primarily due to increased general and administrative expenses of \$37.8 million, of which \$7.5 million related directly to support our growth in China, and a higher effective tax rate all of which were partially offset by increased net sales and higher gross margins. The results of operations for the three months ended September 30, 2018 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2018.

We have three reportable segments – domestic wholesale sales, international wholesale sales, and retail sales, which includes e-commerce sales. We evaluate segment performance based primarily on net sales and gross margins.

Revenue by segment as a percentage of net sales was as follows:

	Three Months Ended	
	September 30,	
	2018	2017
Percentage of revenues by segment:		
Domestic wholesale	24.3 %	26.9 %
International wholesale	45.1 %	43.4 %
Retail	30.6 %	29.7 %
Total	100.0%	100.0%

As of September 30, 2018, we owned and operated 681 stores, which included 465 domestic retail stores and 216 international retail stores. We have established our presence in what we believe to be most of the major domestic retail markets. During the first nine months of 2018, we opened one domestic concept store, one domestic outlet store, 18 domestic warehouse stores, 12 international concept stores, seven international outlet stores, and one international warehouse store. In addition, we closed four domestic concept stores. We review all of our stores for impairment annually, or more frequently if events occur that may be an indicator of impairment, and we carefully review our under-performing stores and consider the potential for non-renewal of leases upon completion of the current term of the applicable lease.

During the remainder of 2018 and in 2019, we intend to focus on: (i) continuing to develop new lifestyle and performance product at affordable prices to increase product count for all customers, (ii) continuing to manage our inventory and expenses to be in line with expected sales levels, (iii) growing our international business, (iv) strategically expanding our global retail distribution channel by opening another 10 to 15 Company-owned retail stores during the remainder of the year, and (v) expanding our product distribution infrastructure in China.

## RESULTS OF OPERATIONS

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2018		2017		2018		2017	
Net sales	\$1,176,395	100.0 %	\$1,094,829	100.0 %	\$3,561,270	100.0 %	\$3,193,571	100.0 %
Cost of sales	612,529	52.1	574,842	52.5	1,853,344	52.0	1,708,765	53.5
Gross profit	563,866	47.9	519,987	47.5	1,707,926	48.0	1,484,806	46.5
Royalty income	4,860	0.4	2,917	0.3	15,732	0.4	10,368	0.3
	568,726	48.3	522,904	47.8	1,723,658	48.4	1,495,174	46.8
Operating expenses:								
Selling	90,138	7.7	89,559	8.2	288,606	8.1	263,318	8.2
General and administrative	354,676	30.1	316,852	28.9	1,080,984	30.4	904,631	28.4
	444,814	37.8	406,411	37.1	1,369,590	38.5	1,167,949	36.6
Earnings from operations	123,912	10.5	116,493	10.7	354,068	9.9	327,225	10.2
Interest income	3,008	0.3	780	0.1	6,280	0.2	1,574	—
Interest expense	(1,199 )	(0.1 )	(1,560 )	(0.1 )	(3,742 )	(0.1 )	(4,895 )	(0.1 )
Other, net	(2,849 )	(0.3 )	2,147	0.1	(6,918 )	(0.2 )	5,507	0.2
Earnings before income tax expense	122,872	10.4	117,860	10.8	349,688	9.8	329,411	10.3
Income tax expense	16,821	1.4	11,030	1.0	45,521	1.3	42,546	1.3
Net earnings	106,051	9.0	106,830	9.8	304,167	8.5	286,865	9.0
Less: Net earnings attributable to non-controlling interests	15,323	1.3	14,520	1.4	50,504	1.4	41,025	1.3
Net earnings attributable to Skechers								
U.S.A., Inc.	\$90,728	7.7 %	\$92,310	8.4 %	\$253,663	7.1 %	\$245,840	7.7 %

## THREE MONTHS ENDED September 30, 2018 COMPARED TO THREE MONTHS ENDED September 30, 2017

## Net sales

Net sales for the three months ended September 30, 2018 were \$1.176 billion, an increase of \$81.6 million, or 7.5%, as compared to net sales of \$1.095 billion for the three months ended September 30, 2017. The increase in net sales came from our international wholesale and global retail businesses from our Women's and Men's Sport, Men's U.S.A., You by Skechers, and Cali divisions partially offset by a decrease in our domestic wholesale segment.

Our domestic wholesale net sales decreased \$8.7 million, or 3.0%, to \$285.4 million for the three months ended September 30, 2018 from \$294.1 million for the three months ended September 30, 2017. The decrease in the domestic wholesale segment's net sales was primarily the result of a 4.4% decrease in average price per pair offset by a 1.5% unit sales volume increase to 12.8 million pairs for the three months ended September 30, 2018 from 12.6 million pairs for the same period in 2017. The decrease in our domestic wholesale segment was also attributable to decreased sales to the off-price channel. The average selling price per pair within the domestic wholesale decreased to \$22.24 per pair for the three months ended September 30, 2018 compared to \$23.27 per pair for the same period last year, which was primarily attributable to a product sales mix with lower average selling prices.

Our international wholesale segment sales increased \$55.9 million, or 11.8%, to \$531.1 million for the three months ended September 30, 2018 compared to sales of \$475.2 million for the three months ended September 30, 2017. Our international wholesale sales consist of direct sales – those we make to department stores and specialty retailers – and sales to our distributors, who in turn sell to retailers in various international regions where we do not sell directly. Direct subsidiary sales increased \$45.8 million, or 11.8%, to \$434.3 million for the three months ended September 30, 2018 compared to net sales of \$388.5 million for the three months ended September 30, 2017. The largest sales increases during the quarter came from several of our European subsidiaries and our joint ventures in China and India, primarily due to increased sales of product from on-line channels. Our distributor sales increased \$10.1 million to \$96.8 million for the three months ended September 30, 2018, an 11.6% increase from sales of \$86.7 million for the three months ended September 30, 2017. The increase was primarily due to increased sales to our distributors in the United Arab Emirates (“U.A.E.”), Russia and Turkey.

Our retail segment sales increased \$34.4 million to \$359.9 million for the three months ended September 30, 2018, a 10.5% increase over sales of \$325.5 million for the three months ended September 30, 2017. The increase in retail sales was primarily attributable to operating an additional net 58 stores and increased comparable store sales of 1.9% resulting from increased sales across several key divisions, including Women's and Men's Sport, Men's USA and Skecher Street divisions. During the third quarter of 2018, we opened one domestic outlet store, five domestic warehouse stores, five international concept stores, one international outlet store, and one international warehouse store. For the three months ended September 30, 2018, our domestic retail sales increased 8.1% compared to the same period in 2017, which was primarily attributable to positive comparable domestic store sales of 3.0% and a net increase of 16 domestic stores. Our international retail store sales increased 15.7% compared to the same period in 2017, which was primarily attributable to a net increase of 20 international stores compared to the prior period.

#### Gross profit

Gross profit for the three months ended September 30, 2018 increased \$43.9 million, or 8.4%, to \$563.9 million as compared to \$520.0 million for the three months ended September 30, 2017. Gross profit as a percentage of net sales, or gross margins, increased to 47.9% for three-month period ended September 30, 2018 from 47.5% for the same period in the prior year. Our domestic wholesale segment gross profit decreased \$0.1 million to \$110.6 million for the three months ended September 30, 2018 as compared to \$110.7 million for the three months ended September 30, 2017, primarily due to lower sales partially offset by higher gross margins. Domestic wholesale margins increased to 38.7% for the three months ended September 30, 2018 from 37.6% for the three months ended September 30, 2017 primarily from product sales mix with higher average gross margins.

Gross profit for our international wholesale segment increased \$20.8 million, or 9.5%, to \$240.1 million for the three months ended September 30, 2018 as compared to \$219.3 million for the three months ended September 30, 2017. International wholesale gross margins were 45.2% for the three months ended September 30, 2018 compared to 46.1% for the three months ended September 30, 2017. Gross margins for our direct subsidiary sales decreased to 49.8% for the three months ended September 30, 2018 compared to 50.6% for the three months ended September 30, 2017. The decrease in international wholesale gross margins was primarily attributable a negative foreign currency exchange rates from a stronger U.S. dollar. Gross margins for our distributor sales were 24.5% for the three months ended September 30, 2018 compared to 26.3% for the three months ended September 30, 2017, which was due to a product sales mix with lower average gross margins.

Gross profit for our retail segment increased \$23.2 million, or 12.2%, to \$213.2 million for the three months ended September 30, 2018 as compared to \$190.0 million for the three months ended September 30, 2017. Gross margins for all our company-owned domestic and international stores and our e-commerce business were 59.3% for the three months ended September 30, 2018 as compared to 58.4% for the three months ended September 30, 2017. Gross margins for our domestic stores, which includes e-commerce, were 62.8% and 60.6% for the three months ended September 30, 2018 and 2017, respectively. The increase in domestic retail gross margins was primarily due to less discounting. Gross margins for our international stores were 52.3% for the three months ended September 30, 2018 as compared to 53.8% for the three months ended September 30, 2017. The decrease in international retail gross margins was primarily attributable to negative foreign currency exchange rates from a stronger U.S. dollar.

Our cost of sales includes the cost of footwear purchased from our manufacturers, duties, quota costs, inbound freight (including ocean, air and freight from the dock to our distribution centers), broker fees and storage costs. Because we include expenses related to our distribution network in general and administrative expenses while some of our competitors may include expenses of this type in cost of sales, our gross margins may not be comparable, and we may report higher gross margins than some of our competitors in part for this reason.

#### Selling expenses

Selling expenses increased by \$0.5 million, or 0.6%, to \$90.1 million for the three months ended September 30, 2018 from \$89.6 million for the three months ended September 30, 2017. As a percentage of net sales, selling expenses were 7.7% and 8.2% for the three months ended September 30, 2018 and 2017, respectively.

Selling expenses consist primarily of the following: sales representative sample costs, sales commissions, trade shows, advertising and promotional costs, which may include television, print ads, ad production costs and point-of-purchase (POP) costs. Selling expenses are not allocated to segments.

### General and administrative expenses

General and administrative expenses increased by \$37.8 million, or 11.9%, to \$354.7 million for the three months ended September 30, 2018 from \$316.9 million for the three months ended September 30, 2017. As a percentage of sales, general and administrative expenses were 30.1% and 28.9% for the three months ended September 30, 2018 and 2017, respectively. The \$37.8 million increase in general and administrative expenses was primarily attributable to approximately \$13.4 million related to supporting our international wholesale operations due to increased sales volumes and expansion, and \$13.3 million of additional operating expenses attributable to opening and operating 20 new international retail stores and 16 new domestic retail stores, since September 30, 2017. In addition, the expenses related to our distribution network, including purchasing, receiving, inspecting, allocating, warehousing and packaging of our products, increased \$2.1 million to \$61.5 million for the three months ended September 30, 2018 as compared to \$59.4 million for the same period in the prior year. The increase in warehousing costs was primarily due to increased sales volumes worldwide.

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

### Other income (expense)

Interest income increased \$2.2 million to \$3.0 million for the three months ended September 30, 2018, as compared to \$0.8 million at September 30, 2017. The increase in interest income was due primarily due to increased interest rates and higher average cash and investment balances as compared to the prior year period. Interest expense decreased by \$0.4 million to \$1.2 million for the three months ended September 30, 2018 compared to \$1.6 million for the same period in 2017. Interest expense decreased primarily due to reduced interest paid to our foreign manufacturers. Other expense increased \$4.9 million to \$2.8 million for the three months ended September 30, 2018 as compared to other income of \$2.1 million for the same period in 2017. The increase in other expense was primarily attributable to foreign currency exchange loss of \$2.0 million for the three months ended September 30, 2018, as compared to a foreign currency exchange gain of \$1.7 million for the three months ended September 30, 2017. This increase foreign currency exchange loss was primarily attributable to the impact of a stronger U.S. dollar on our intercompany investments in our non-U.S. subsidiaries.

### Income taxes

Income tax expense and the effective tax rate for the three months ended September 30, 2018 and 2017 were as follows (dollar amounts in thousands):

	Three Months Ended	
	September 30, 2018	2017
Income tax expense	\$16,821	\$11,030
Effective tax rate	13.7 %	9.4 %

The tax provisions for the three months ended September 30, 2018 and 2017 were computed using the estimated effective tax rates applicable to each of the domestic and international taxable jurisdictions for the full year. We estimate our effective annual tax rate to be between 13% and 15% for the full year, which implies a fourth quarter effective rate of between 17% and 20%. Our effective tax rate is subject to management's quarterly review and revision, as necessary.

Our provision for income tax expense and effective income tax rate are significantly impacted by the mix of our domestic and foreign earnings (loss) before income taxes. In the foreign jurisdictions in which we have operations, the applicable statutory rates range from 0% to 34%, which on average are generally significantly lower than the U.S. federal and state combined statutory rate of approximately 26%.

For the three months ended September 30, 2018, the increase in the effective tax rate was primarily due to increased U.S. tax on foreign earnings resulting from changes in U.S. tax law under the Tax Act.

As of September 30, 2018, we had approximately \$802.8 million in cash and cash equivalents, of which \$405.0 million, or 50.5%, was held outside the U.S. Of the \$405.0 million held by our non-U.S. subsidiaries, approximately \$235.3 million is available for repatriation to the U.S. without incurring U.S. income taxes and applicable non-U.S. income and withholding taxes in excess of the amounts accrued in our condensed consolidated financial statements as of September 30, 2018.

Our cash and cash equivalents held in the U.S. and cash provided from operations are sufficient to meet our liquidity needs in the U.S. for the next twelve months. However, in anticipation of the needs of our share repurchase program and the need to provide payment of our provisional Transition Tax liability, we may begin repatriating certain funds held outside the U.S. for which all applicable U.S. and non-U.S. tax has been fully provided as of September 30, 2018. Because of the need for cash for operating capital and continued overseas expansion, we also do not foresee the need for any of our foreign subsidiaries to distribute funds up to an intermediate foreign parent company in any form of taxable dividend. Under current applicable tax laws, if we choose to repatriate some or all of the funds we have designated as indefinitely reinvested outside the U.S., the amount repatriated would not be subject to U.S. income taxes but may be subject to applicable non-U.S. income and withholding taxes.

#### Non-controlling interests in net income and loss of consolidated subsidiaries

Net earnings attributable to non-controlling interests for the three months ended September 30, 2018 increased \$0.8 million to \$15.3 million as compared to \$14.5 million for the same period in 2017 primarily attributable to increased profitability by our joint ventures. Non-controlling interests represents the share of net earnings that is attributable to our joint venture partners.

#### NINE MONTHS ENDED September 30, 2018 COMPARED TO NINE MONTHS ENDED September 30, 2017

##### Net sales

Net sales for the nine months ended September 30, 2018 were \$3.561 billion, an increase of \$367.7 million, or 11.5%, as compared to net sales of \$3.194 billion for the nine months ended September 30, 2017. The increase in net sales came from our international wholesale and global retail businesses, which were partially offset by lower sales in our domestic wholesale segment.

Our domestic wholesale net sales decreased \$2.0 million, or 0.2%, to \$991.7 million for the nine months ended September 30, 2018 from \$993.7 million for the nine months ended September 30, 2017. The decrease in the domestic wholesale segment's net sales was primarily the result of a 4.9% decrease in average price per pair partially offset by a 4.9% unit sales volume increase to 47.0 million pairs for the nine months ended September 30, 2018 from 44.8 million pairs for the same period in 2017. The decrease in our domestic wholesale segment was primarily attributable to decreased sales to our off-price customers. The average selling price per pair within the domestic wholesale segment decreased \$1.08 to \$21.10 per pair for the nine months ended September 30, 2018 from \$22.18 per pair for the same period in 2017, which was attributable to a product sales mix with lower average selling prices.

Our international wholesale segment sales increased \$250.3 million, or 18.9%, to \$1.574 billion for the nine months ended September 30, 2018 compared to sales of \$1.324 billion for the nine months ended September 30, 2017. Direct subsidiary sales increased \$263.1 million, or 24.5%, to \$1,335.4 million for the nine months ended September 30, 2018 compared to net sales of \$1.072 billion for the nine months ended September 30, 2017. The largest sales increases during the period came from our subsidiaries in Germany and our joint ventures in China and India, primarily due to increased sales of product in our on-line channels and increased third-party points of sale. Our distributor sales decreased \$12.9 million to \$238.5 million for the nine months ended September 30, 2018, a 5.1% decrease from sales of \$251.4 million for the nine months ended September 30, 2017. The decrease was primarily due



to decreased sales to our distributors in the U.A.E., Australia and New Zealand.

Our retail segment sales increased \$119.5 million to \$995.7 million for the nine months ended September 30, 2018, a 13.6% increase over sales of \$876.2 million for the nine months ended September 30, 2017. The increase in retail sales was primarily attributable to increased comparable store sales of 4.5% resulting from increased sales of product from our Women's and Men's Sport, Men's USA and Kids' divisions. During the nine months ended September 30, 2018, we opened one domestic concept store, one domestic outlet store, 18 domestic warehouse stores, 12 international concept stores, and seven international outlet stores, and one international warehouse store. We closed four domestic concept stores. For the nine months ended September 30, 2018, our domestic retail sales increased 9.2% compared to the same period in 2017, which was primarily attributable to positive comparable domestic store sales of 3.4% and a net increase of 29 domestic stores during the nine months ended September 30, 2018. Our international retail store sales increased 23.2%, which was primarily attributable to positive comparable international store sales of 7.4% and a net increase of 29 international stores when compared to the prior year period.

## Gross profit

Gross profit for the nine months ended September 30, 2018 increased \$223.1 million to \$1.708 billion as compared to \$1.485 billion for the nine months ended September 30, 2017. Gross profit as a percentage of net sales, or gross margin, increased to 48.0% for the nine months ended September 30, 2018 from 46.5% for the same period in the prior year. Our domestic wholesale segment gross profit decreased \$4.3 million, or 1.2%, to \$372.2 million for the nine months ended September 30, 2018 compared to \$376.5 million for the nine months ended September 30, 2017, primarily attributable lower average margins and sales. Domestic wholesale margins decreased to 37.5% for the nine months ended September 30, 2018 from 37.9% for the same period in the prior year. The decrease in domestic wholesale margins was primarily attributable to lower average selling prices.

Gross profit for our international wholesale segment increased \$157.4 million, or 26.5%, to \$752.3 million for the nine months ended September 30, 2018 compared to \$594.9 million for the nine months ended September 30, 2017. International wholesale gross margins were 47.8% for the nine months ended September 30, 2018 compared to 44.9% for the nine months ended September 30, 2017. Gross margins for our direct subsidiary sales increased to 51.8% for the nine months ended September 30, 2018 as compared to 49.2% for the nine months ended September 30, 2017, which was primarily attributable to a product mix with sales of more products with higher margins. Gross margins for our distributor sales were 25.7% for the nine months ended September 30, 2018 as compared to 26.6% for the nine months ended September 30, 2017.

Gross profit for our retail segment increased \$70.0 million, or 13.6%, to \$583.4 million for the nine months ended September 30, 2018 as compared to \$513.4 million for the nine months ended September 30, 2017. Gross margins for all company-owned domestic and international stores and our e-commerce business were 58.6% for the nine months ended September 30, 2018 and September 30, 2017, respectively. Gross margin for our domestic stores was 61.1% for the nine months ended September 30, 2018 as compared to 60.5% for the nine months ended September 30, 2017. The increase in domestic retail gross margins was primarily attributable to higher margin product mix. Gross margins for our international stores were 53.6% and 54.5% for the nine months ended September 30, 2018 and 2017, respectively. The decrease in international retail gross margins was primarily attributable to a product sales mix with lower margin products.

## Selling expenses

Selling expenses increased by \$25.3 million, or 9.6%, to \$288.6 million for the nine months ended September 30, 2018 from \$263.3 million for the nine months ended September 30, 2017. As a percentage of net sales, selling expenses were 8.1% and 8.2% for the nine months ended September 30, 2018 and 2017, respectively. The increase in selling expenses was primarily attributable to higher advertising expenses of \$18.8 million to support our global growth and higher sales commissions of \$5.3 million due to increased net sales for the nine months ended September 30, 2018.

## General and administrative expenses

General and administrative expenses increased by \$176.4 million, or 19.5%, to \$1.081 billion for the nine months ended September 30, 2018 from \$904.6 million for the nine months ended September 30, 2017. As a percentage of sales, general and administrative expenses were 30.4% and 28.4% for the nine months ended September 30, 2018 and 2017, respectively. The increase in general and administrative expenses was primarily attributable to \$5.7 million in additional legal costs, \$84.9 million related to supporting our international operations due to increased sales volumes and expansion into newer markets, \$43.3 million of additional operating expenses attributable to operating 29 new international and 29 new domestic retail stores, since September 30, 2017. The expenses related to our distribution network, including purchasing, receiving, inspecting, allocating, warehousing and packaging of our products,

increased \$23.4 million to \$191.4 million for the nine months ended September 30, 2018 from \$168.0 million for the nine months ended September 30, 2017. The increase in warehousing costs was primarily due to increased sales volumes worldwide.

Other income (expense)

Interest income increased \$4.7 million to \$6.3 million for the nine months ended September 30, 2018, as compared to \$1.6 million at September 30, 2017. The increase in interest income was due primarily due to increased interest rates and higher average cash and investment balances as compared to the prior year period. Interest expense decreased \$1.2 million to \$3.7 million for the nine months ended September 30, 2018 compared to \$4.9 million for the same period in 2017. Interest expense decreased primarily due to reduced interest paid to our foreign manufacturers. Other expense increased \$12.4 million to \$6.9 million for the nine months ended September 30, 2018 as compared to other income of \$5.5 million for the same period in 2017 due to increased foreign currency exchange losses. The increase in other expense was primarily attributable to foreign currency exchange loss of \$6.0 million for the nine months ended September 30, 2018, as compared to a foreign exchange gain of \$5.7 million for the nine months ended September 30, 2017. This increased foreign currency exchange loss was primarily attributable to the impact of a stronger U.S. dollar on our intercompany investments in our foreign subsidiaries.

## Income taxes

Income tax expense and the effective tax rate for the nine months ended September 30, 2018 and 2017 were as follows (dollar amounts in thousands):

	Nine Months Ended			
	September 30,			
	2018	2017		
Income tax expense	\$45,521	\$42,546		
Effective tax rate	13.0	%	12.9	%

The tax provisions for the nine months ended September 30, 2018 and 2017 were computed using the estimated effective tax rates applicable to each of the domestic and international taxable jurisdictions for the full year. We estimate its effective tax rate to be between 13% and 15% for the full year, which implies a fourth quarter effective tax rate of between 17% and 20%. Our effective tax rate is subject to management's quarterly review and revision, as necessary.

Our provision for income tax expense and effective income tax rate are significantly impacted by the mix of our domestic and foreign earnings (loss) before income taxes. In the foreign jurisdictions in which we have operations, the applicable statutory rates range from 0% to 34%, which on average are generally significantly lower than the U.S. federal and state combined statutory rate of approximately 26%.

For the nine months ended September 30, 2018, the increase in the effective tax rate was due to increased U.S. tax on foreign earnings resulting from changes in U.S. tax law under the Tax Act.

As of September 30, 2018, we had approximately \$802.8 million in cash and cash equivalents, of which \$405.0 million, or 50.5%, was held outside the U.S. Of the \$405.0 million held by our non-U.S. subsidiaries, approximately \$235.3 million is available for repatriation to the U.S. without incurring U.S. income taxes and applicable non-U.S. income and withholding taxes in excess of the amounts accrued in our condensed consolidated financial statements as of September 30, 2018.

## Non-controlling interests in net income of consolidated subsidiaries

Net earnings attributable to non-controlling interests for the nine months ended September 30, 2018 increased \$9.5 million to \$50.5 million as compared to \$41.0 million for the same period in 2017 attributable to increased profitability by our joint ventures. Non-controlling interests represents the share of net earnings that is attributable to our joint venture partners.

## LIQUIDITY AND CAPITAL RESOURCES

## Cash Flows

Our working capital at September 30, 2018 was \$1.616 billion, an increase of \$108.4 million from working capital of \$1.508 billion at December 31, 2017. Our cash and cash equivalents at September 30, 2018 were \$802.8 million, compared to \$736.4 million at December 31, 2017. The increase in cash and cash equivalents of \$66.4 million, after consideration of the effect of exchange rates, was the result of \$23.5 million due to the reclassification of our return reserve, decreased inventories of \$99.3 million, an increase in accounts payable of \$48.3 million and our net earnings of \$304.2 million which were partially offset by an increase in accounts receivables of \$143.7 million. Our short-term and long-term investments were \$87.3 million and \$91.1 million, respectively at September 30, 2018. Our primary sources of operating cash are collections from customers on wholesale and retail sales. Our primary uses of cash are inventory purchases, selling, general and administrative expenses, and capital expenditures.

#### Operating Activities

For the nine months ended September 30, 2018, net cash provided by operating activities was \$412.8 million as compared to \$175.5 million for the nine months ended September 30, 2017. The \$237.3 million increase in cash flows provided by operating activities for the nine months ended September 30, 2018, primarily resulted from an increase in cash flows generated from accounts payable of \$73.5 million from reduced inventory purchases, a decrease in cash used by accounts receivable of \$20.6 million from increased cash collections, and an increase in cash generated by higher net earnings of \$17.3 million.

## Investing Activities

Net cash used in investing activities was \$258.3 million for the nine months ended September 30, 2018 as compared to \$103.9 million for the nine months ended September 30, 2017. The \$154.4 million increase in net cash used in investing activities for the nine months ended September 30, 2018 as compared to the same period in the prior year was primarily the result of a net increase in purchases and maturities of investments of \$159.4 million, offset by lower capital expenditures of \$4.9 million. Capital expenditures were \$97.3 million for the nine months ended September 30, 2018 primarily consisted of \$37.9 million for new store openings and remodels and \$31.1 million to support our international wholesale operations. This was compared to capital expenditures of \$102.2 million for the nine months ended September 30, 2017, which consisted of \$56.5 million for new store openings and remodels and \$3.1 million paid for equipment costs for increased automation at our European Distribution Center. We expect our ongoing capital expenditures for the remainder of 2018 to be approximately \$20.0 million to \$25.0 million, which includes opening an additional 10 to 15 Company-owned retail stores and several store remodels and investments in our international operations. Except for capital expenses related to enhancing our distribution capabilities, we expect to fund our capital expenditures through existing cash balances, investment balances and cash from operations.

## Financing Activities

Net cash used in financing activities was \$79.1 million during the nine months ended September 30, 2018 compared to \$2.5 million in net cash provided by financing activities during the nine months ended September 30, 2017. The \$81.6 million increase in cash used in financing activities for the nine months ended September 30, 2018 as compared to the same period in the prior year is primarily attributable to repurchases of our Class A common stock of \$58.0 million, and increased payments for taxes related to net share settlement of equity awards of \$11.4 million and distribution to non-controlling interest of \$18.7 million.

## Capital Resources and Prospective Capital Requirements

### Share Repurchase Program

On February 6, 2018, the Company's Board of Directors authorized a share repurchase program pursuant to which the Company may, from time to time, purchase shares of its Class A common stock, par value \$0.001 per share ("Class A common stock"), for an aggregate repurchase price not to exceed \$150.0 million. The Share Repurchase Program expires on February 6, 2021. Share repurchases may be executed through various means, including, without limitation, open market transactions, privately negotiated transactions or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Act of 1934, as amended, subject to market conditions, applicable legal requirements and other relevant factors. The Share Repurchase Program does not obligate the Company to acquire any particular amount of shares of Class A common stock and the program may be suspended or discontinued at any time. As of September 30, 2018, there was \$92.0 million available under the Share Repurchase Program.

### Financing Arrangements

On September 29, 2018, through a subsidiary of our Chinese joint-venture ("the Subsidiary"), we entered into a 700 million yuan loan agreement with China Construction Bank Corporation ("the China DC Loan Agreement"). The proceeds from the China DC Loan Agreement will be used to finance the construction of our distribution center in China. Interest will be paid quarterly. The interest rate will float and be calculated at a reference rate provided by the People's Bank of China. The interest rate may increase or decrease over the life of the loan and will be evaluated every 12 months. The principal of the loan will be repaid in semi-annual installments, beginning in 2021, of variable amounts as specified in the China DC Loan Agreement. The China DC Loan Agreement contains customary

affirmative and negative covenants for secured credit facilities of this type, including covenants that limit the ability of the joint venture to, among other things, allow external investment to be added, pledge assets, issue debt with priority over the China DC Loan Agreement, and adjust the capital stock structure of the Subsidiary. The China DC Loan Agreement matures on September 28, 2023. The obligations of the Subsidiary under the China DC Loan Agreement are jointly and severally guaranteed by our Chinese joint venture. As of September 30, 2018 there was \$2.8 million outstanding under this credit facility, which is classified as short-term borrowings in our consolidated balance sheets.

On June 30, 2015, we entered into a \$250.0 million loan and security agreement, subject to increase by up to \$100.0 million, (the "Credit Agreement"), with the following lenders: Bank of America, N.A., MUFG Union Bank, N.A. and HSBC Bank USA, National Association. The Credit Agreement matures on June 30, 2020. The Credit Agreement replaces the credit agreement dated June 30, 2009, which expired on June 30, 2015. The Credit Agreement permits us and certain of our subsidiaries to borrow based on a percentage of eligible accounts receivable plus the sum of (a) the lesser of (i) a percentage of eligible inventory to be sold at wholesale and (ii) a percentage of net orderly liquidation value of eligible inventory to be sold at wholesale, plus (b) the lesser of (i) a percentage of the value of eligible inventory to be sold at retail and (ii) a percentage of net orderly liquidation value of eligible inventory to be sold at retail, plus (c) the lesser of (i) a percentage of the value of eligible in-transit inventory and (ii) a percentage of the net orderly liquidation value of eligible in-transit inventory. Borrowings bear interest at our election based on (a) LIBOR or (b) the greater of (i) the Prime Rate, (ii) the Federal Funds Rate plus 0.5% and (iii) LIBOR for a 30-day period plus 1.0%, in each case, plus an applicable

margin based on the average daily principal balance of revolving loans available under the Credit Agreement. We pay a monthly unused line of credit fee of 0.25%, payable on the first day of each month in arrears, which is based on the average daily principal balance of outstanding revolving loans and undrawn amounts of letters of credit outstanding during such month. The Credit Agreement further provides for a limit on the issuance of letters of credit to a maximum of \$100.0 million. The Credit Agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including covenants that will limit the ability of the Company and its subsidiaries to, among other things, incur debt, grant liens, make certain acquisitions, dispose of assets, effect a change of control of the Company, make certain restricted payments including certain dividends and stock redemptions, make certain investments or loans, enter into certain transactions with affiliates and certain prohibited uses of proceeds. The Credit Agreement also requires compliance with a minimum fixed-charge coverage ratio if Availability drops below 10% of the Revolver Commitments (as such terms are defined in the Credit Agreement) until the date when no event of default has existed and Availability has been over 10% for 30 consecutive days. We paid closing and arrangement fees of \$1.1 million on this facility, which are being amortized to interest expense over the five-year life of the facility. As of September 30, 2018, there was \$0.1 million outstanding under this credit facility, which is classified as short-term borrowings in our condensed consolidated balance sheets. The remaining balance in short-term borrowings, as of September 30, 2018, is related to our international operations.

On April 30, 2010, HF Logistics-SKX, LLC (the "JV"), through HF Logistics-SKX T1, LLC, a Delaware limited liability company and a wholly-owned subsidiary of the JV ("HF-T1"), entered into a construction loan agreement with Bank of America, N.A. as administrative agent and as a lender, and Raymond James Bank, FSB, as a lender (collectively, the "Construction Loan Agreement"), pursuant to which the JV obtained a loan of up to \$55.0 million used for construction of the Project on the Property (the "Original Loan"). On November 16, 2012, HF-T1 executed a modification to the Construction Loan Agreement (the "Modification"), which added OneWest Bank, FSB as a lender, increased the borrowings under the Original Loan to \$80.0 million and extended the maturity date of the Original Loan to October 30, 2015. On August 11, 2015, the JV through HF-T1 entered into an amended and restated loan agreement with Bank of America, N.A., as administrative agent and as a lender, and CIT Bank, N.A. (formerly known as OneWest Bank, FSB) and Raymond James Bank, N.A., as lenders (collectively, the "Amended Loan Agreement"), which amends and restates in its entirety the Construction Loan Agreement and the Modification.

As of the date of the Amended Loan Agreement, the outstanding principal balance of the Original Loan was \$77.3 million. In connection with this refinancing of the Original Loan, the JV, the Company and HF agreed that we would make an additional capital contribution of \$38.7 million to the JV for the JV through HF-T1 to use to make a payment on the Original Loan. The payment equaled our 50% share of the outstanding principal balance of the Original Loan. Under the Amended Loan Agreement, the parties agreed that the lenders would loan \$70.0 million to HF-T1 (the "New Loan"). The New Loan was used by the JV through HF-T1 to (i) refinance all amounts owed on the Original Loan after taking into account the payment described above, (ii) pay \$0.9 million in accrued interest, loan fees and other closing costs associated with the New Loan and (iii) make a distribution of \$31.3 million less the amounts described in clause (ii) to HF. Pursuant to the Amended Loan Agreement, the interest rate on the New Loan is the LIBOR Daily Floating Rate (as defined in the Amended Loan Agreement) plus a margin of 2%. The maturity date of the New Loan is August 12, 2020, which HF-T1 has one option to extend by an additional 24 months, or until August 12, 2022, upon payment of a fee and satisfaction of certain customary conditions. On August 11, 2015, HF-T1 and Bank of America, N.A. entered into an ISDA Master Agreement (together with the schedule related thereto, the "Swap Agreement") to govern derivative and/or hedging transactions that HF-T1 concurrently entered into with Bank of America, N.A. Pursuant to the Swap Agreement, on August 14, 2015, HF-T1 entered into a confirmation of swap transactions (the "Interest Rate Swap") with Bank of America, N.A. The Interest Rate Swap has an effective date of August 12, 2015 and a maturity date of August 12, 2022, subject to early termination at the option of HF-T1, commencing on August 1, 2020. The Interest Rate Swap fixes the effective interest rate on the New Loan at 4.08% per annum. Pursuant to the terms of the JV, HF Logistics is responsible for the related interest expense on the New Loan, and any amounts related to the Swap Agreement. The full amount of interest expense related to the New Loan has



been included in our condensed consolidated statements of equity within non-controlling interests. The Amended Loan Agreement and the Swap Agreement are subject to customary covenants and events of default. Bank of America, N.A. also acts as a lender and syndication agent under our credit agreement dated June 30, 2015. We had \$65.5 million outstanding under the Amended Loan Agreement, of which \$1.5 million and \$64.0 million is included in current installments of long-term borrowings and long-term borrowings, respectively, as of September 30, 2018.

As of September 30, 2018, outstanding short-term and long-term borrowings were \$87.0 million, of which \$65.8 million relates to loans for our domestic distribution center and the remaining balance relates to our international operations. Our long-term debt obligations contain both financial and non-financial covenants, including cross-default provisions. We were in compliance with all debt covenants under the Amended Loan Agreement and the Credit Agreement as of the date of this quarterly report.

We believe that anticipated cash flows from operations, available borrowings under our credit agreement, existing cash and investment balances and current financing arrangements will be sufficient to provide us with the liquidity necessary to fund our anticipated working capital and capital requirements at least through November 30, 2019. Our future capital requirements will depend on many factors, including, but not limited to, the global economy and the outlook for and pace of sustainable growth in our markets, the levels at which we maintain inventory, sale of excess inventory at discounted prices, the market acceptance of our footwear, the

success of our international operations, the costs of expanding our product distribution infrastructure in China, available borrowings under our China DC Loan Agreement, the levels of advertising and marketing required to promote our footwear, the extent to which we invest in new product design and improvements to our existing product design, costs associated with building new corporate offices, any potential acquisitions of other brands or companies, and the number and timing of new store openings and the amount of share repurchases. To the extent that available funds are insufficient to fund our future activities, we may need to raise additional funds through public or private financing of debt or equity. We have been successful in the past in raising additional funds through financing activities; however, we cannot be assured that additional financing will be available to us or that, if available, it can be obtained on past terms which have been favorable to our stockholders and us. Failure to obtain such financing could delay or prevent our current business plans, which could adversely affect our business, financial condition and results of operations. In addition, if additional capital is raised through the sale of additional equity or convertible securities, dilution to our stockholders could occur.

#### OFF-BALANCE SHEET ARRANGEMENTS

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

#### CONTRACTUAL OBLIGATIONS

On October 19, 2018, through a subsidiary of our Chinese joint venture (“the Subsidiary”), we entered into a 50 million yuan revolving loan agreement with China Construction Bank Corporation (“the China DC Revolving Loan Agreement”). The proceeds from the China DC Revolving Loan Agreement will be used to finance the construction and operation of our distribution center in China. Interest will be paid quarterly. The interest rate will be based upon the prime rate from the People’s Bank of China less a discount. As specified in the China DC Revolving Loan Agreement, the entire principal balance of the loan will be repaid when the China DC Revolving Loan Agreement matures on October 18, 2019. The Subsidiary has the option to extend the China DC Revolving Agreement, conditioned upon the satisfaction of certain terms. The China DC Revolving Loan Agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including covenants that will limit the ability of the Subsidiary, to among other things, allow external investment to be added, pledge assets, issue debt with priority over the China DC Revolving Loan Agreement, and adjust the capital stock structure of the Subsidiary. The obligations of the Subsidiary under the China DC Revolving Loan Agreement are jointly and severally guaranteed by our Chinese joint venture.

#### CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES

Management’s Discussion and Analysis of Financial Condition and Results of Operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”). The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. For a detailed discussion of our critical accounting policies, please refer to our annual report on Form 10-K for the year ended December 31, 2017 filed with the SEC on March 1, 2018. Our critical accounting policies and estimates did not change materially during the quarter ended September 30, 2018.

Effective January 1, 2018, we adopted Accounting Standards Codification 606 “Revenue from Contracts with Customers” (“ASC 606”). Refer to Note 1 – General in the accompanying Notes to our Condensed Consolidated Financial Statements.

#### Recent Accounting Pronouncements

Refer to the accompanying Notes to the Condensed Consolidated Financial Statements for recently adopted and recently issued accounting pronouncements.

#### QUARTERLY RESULTS AND SEASONALITY

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

We have experienced, and expect to continue to experience, variability in our net sales and operating results on a quarterly basis. Our domestic customers generally assume responsibility for scheduling pickup and delivery of purchased products. Any delay in scheduling or pickup which is beyond our control could materially negatively impact our net sales and results of operations for any given quarter. We believe the factors which influence this variability include (i) the timing of our introduction of new footwear products, (ii) the level of consumer acceptance of new and existing products, (iii) general economic and industry conditions that affect consumer spending and retail purchasing, (iv) the timing of the placement, cancellation or pickup of customer orders, (v) increases in the number of employees and overhead to support growth, (vi) the timing of expenditures in anticipation of increased sales and customer delivery requirements, (vii) the number and timing of our new retail store openings and (viii) actions by competitors. Because of these and other factors including those referenced or incorporated by reference in our annual report on Form 10-K for the year ended December 31, 2017 under the captions “Item 1A: Risk Factors” and “Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations,” the operating results for any particular quarter are not necessarily indicative of the results for the full year.

#### INFLATION

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

#### EXCHANGE RATES

Although we currently invoice most of our customers in U.S. dollars, changes in the value of the U.S. dollar versus the local currency in which our products are sold, along with economic and political conditions of such foreign countries, could adversely affect our business, financial condition and results of operations. Purchase prices for our products may be impacted by fluctuations in the exchange rate between the U.S. dollar and the local currencies of the contract manufacturers, which may have the effect of increasing our cost of goods in the future. In addition, the weakening of an international customer’s local currency and banking market may negatively impact such customer’s ability to meet their payment obligations to us. We regularly monitor the creditworthiness of our international customers and make credit decisions based on both prior sales experience with such customers and their current financial performance, as well as overall economic conditions. While we currently believe that our international customers have the ability to meet all of their obligations to us, there can be no assurance that they will continue to be able to meet such obligations. During 2017 and the first nine months of 2018, exchange rate fluctuations did not have a material impact on our net sales or inventory costs. We do not engage in hedging activities with respect to such exchange rate risk.

#### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest rate fluctuations. As of September 30, 2018, we have \$12.7 million and \$68.3 million of outstanding short-term and long-term borrowings, respectively, subject to changes in interest rates. A 200 basis point increase in interest rates would have increased interest expense by approximately \$0.3 million for the quarter ended September 30, 2018. We do not expect any changes in interest rates to have a material impact on our financial condition or results of operations or cash flows during the remainder of 2018. The interest rate charged on our domestic secured line of

credit facility is based on the prime rate of interest, our domestic distribution center loan is based on the one month LIBOR, and our China DC Loan and China DC Revolving Loan are based on variable-rates provided by the People's Bank of China. Changes in the prime rate of interest or the LIBOR interest rate will have an effect on the interest charged on outstanding balances.

We may enter into derivative financial instruments such as interest rate swaps in order to limit our interest rate risk on our long-term debt. We will not enter into derivative transactions for speculative purposes. We had one derivative instrument in place as of September 30, 2018 to hedge the cash flows on our \$65.5 million variable rate debt on our domestic distribution center. This instrument was a variable to fixed derivative with a notional amount of \$65.5 million at September 30, 2018. Our average receive rate was one month LIBOR and the average pay rate was 2.08%. The rate swap agreement utilized by us effectively modifies our exposure to interest rate risk by converting our floating-rate debt to a fixed rate basis over the life of the loan, thus reducing the impact of interest-rate changes on future interest payments.

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

Assets and liabilities outside the United States are located in regions where we have subsidiaries or joint ventures: Asia, Central America, Europe, Middle East, North America, and South America. Our investments in foreign subsidiaries and joint ventures with a functional currency other than the U.S. dollar are generally considered long-term. Accordingly, we do not hedge these net investments. The fluctuation of foreign currencies resulted in a cumulative foreign currency translation loss of \$15.4 million and a cumulative foreign currency translation gain of \$8.6 million for the nine months ended September 30, 2018 and 2017, respectively, that are deferred and recorded as a component of accumulated other comprehensive income in stockholders' equity. A 200 basis point reduction in each of these exchange rates at September 30, 2018 would have reduced the values of our net investments by approximately \$28.2 million.

#### ITEM 4. CONTROLS AND PROCEDURES

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

#### EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We have established "disclosure controls and procedures" that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods and that such information is accumulated and communicated to the officers who certify our financial reports as well as other members of senior management to allow timely decisions regarding required disclosures. As of the end of the period covered by this quarterly report on Form 10-Q, we evaluated under the supervision and with the participation of our management, including our CEO and CFO, the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective, at the reasonable assurance level, as of such time.

#### CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting during the three months ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### INHERENT LIMITATIONS ON EFFECTIVENESS OF CONTROLS

Our management, including our CEO and CFO, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be

considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements attributable to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Assessments of any evaluation of controls' effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements as a result of error or fraud may occur and not be detected.

## PART II – OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

Converse, Inc. v. Skechers U.S.A., Inc. — On October 14, 2014, Converse filed an action against our company in the United States District Court for the Eastern District of New York, Brooklyn Division, Case 1:14-cv-05977-DLI-MDG, alleging trademark infringement, false designation of origin, unfair competition, trademark dilution and deceptive practices arising out of our alleged use of certain design elements on footwear. The complaint seeks, among other things, injunctive relief, profits, actual damages, enhanced damages, punitive damages, costs and attorneys' fees. On October 14, 2014, Converse also filed a complaint naming 27 respondents including our company with the U.S. International Trade Commission (the "ITC" or "Commission"), Federal Register Doc. 2014 24890, alleging violations of federal law in the importation into and the sale within the United States of certain footwear. Converse has requested that the Commission issue a general exclusion order, or in the alternative a limited exclusion order, and cease and desist orders. On December 8, 2014, the District Court stayed the proceedings before it. On December 19, 2014, Skechers responded to the ITC complaint, denying the material allegations and asserting affirmative defenses. A trial before an administrative law judge of the ITC was held in August 2015. On November 15, 2015, the ITC judge issued his interim decision finding that certain discontinued products (Daddy's Money and HyDee HyTops) infringed on Converse's intellectual property, but that other, still active product lines (Twinkle Toes and Bobs Utopia) did not. On February 3, 2016, the ITC decided that it would review in part certain matters that were decided by the ITC judge. On June 28, 2016, the full ITC issued a ruling affirming that Skechers Twinkle Toes and Bobs canvas shoes do not infringe Converse's Chuck Taylor Midsole Trademark and affirming that Converse's common law trademark was invalid. The full ITC also invalidated Converse's registered trademark. Converse appealed this decision to the United States Court of Appeals for the Federal Circuit. On January 27, 2017, Converse filed its appellate brief but did not contest the portion of the decision that held that Skechers Twinkle Toes and Bobs canvas shoes do not infringe. On June 26, 2017, we filed our responsive brief, on February 8, 2018 the court heard oral argument, and on June 7, 2018 the Court requested supplemental briefing on certain issues. On October 30, 2018, the United States Court of Appeals for the Federal Circuit vacated the ITC's ruling and remanded the matter back to the ITC for further proceedings. While it is too early to predict the outcome of these legal proceedings or whether an adverse result in either or both of them would have a material adverse impact on our operations or financial position, we believe we have meritorious defenses and intend to defend these legal matters vigorously.

Nike, Inc. v. Skechers USA, Inc.— On January 4, 2016, Nike filed an action against our company in the United States District Court for the District of Oregon, Case No. 3:16-cv-0007, alleging that certain Skechers shoe designs (Men's Burst, Women's Burst, Women's Flex Appeal, Men's Flex Advantage, Girls' Skech Appeal, and Boys' Flex Advantage) infringe the claims of eight design patents. Nike seeks injunctive relief, disgorgement of Skechers' profits, damages (including treble damages), pre-judgment and post-judgment interest, attorneys' fees, and costs. In April and May, 2016, we filed petitions with the United States Patent and Trademark Office's Patent Trial and Appeal Board (the "PTAB") for inter partes review of all eight design patents, seeking to invalidate those patents. In September and November 2016, the Patent Trial and Appeal Board denied each of our petitions. On January 6, 2017, we filed several additional petitions for inter partes review with the PTAB, seeking to invalidate seven of the eight designs patents that Nike is asserting. In July 2017, we were notified that the PTAB granted our petitions and instituted inter partes review proceedings with respect to two of the seven design patents but denied our petitions as to the others. In June 2017, we filed a motion to transfer venue from the District of Oregon to the Central District of California based on a recent United States Supreme Court decision and the motion was granted in late 2017. On June 28, 2018, the PTAB issued final decisions in the two inter partes review proceedings, rejecting the invalidity challenges made by our company in those proceedings. On June 4, 2018, the Court, over Nike's opposition, granted our request for a claim construction hearing. A claim construction hearing was held on August 28, 2018 and we are currently waiting for a ruling. While it is too early to predict the outcome of the case or whether an adverse result would have a material adverse impact on our operations or financial position, we believe we have meritorious defenses and intend to defend this legal matter



vigorously.

Steamfitters Local 449 Pension Plan v. Skechers USA, Inc., Robert Greenberg and David Weinberg. – On October 20, 2017, the Steamfitters Local 449 Pension Plan filed a securities class action, on behalf of itself and purportedly on behalf of other shareholders who purchased Skechers stock in a five-month period in 2015, against our company and certain of its officers in the United States District Court for the Southern District of New York, case number 1:17-cv-08107. On April 4, 2018, the plaintiffs filed an amended and consolidated complaint and on July 24, 2018 plaintiffs filed a second amended and consolidated complaint. The lawsuit alleges that, between April 23 and October 22, 2015, we made materially false statements or omissions of material fact about the anticipated performance of our Domestic Wholesale segment and asserts claims for unspecified damages, attorneys' fees and equitable relief based on two counts for alleged violations of federal securities laws. Given the early stage of this proceeding and the limited information available, we cannot predict the outcome of this legal proceeding or whether an adverse result in this case would have a material adverse impact on our operations or financial position. We believe we have meritorious defenses and intend to defend this matter vigorously.

Laborers Local 235 Benefit Fund v. Skechers USA, Inc. Robert Greenberg, David Weinberg and John Vandemore - On September 4, 2018, Laborers Local 235 Benefit Fund filed a securities class action on behalf of itself and purportedly on behalf of other shareholders who purchased the company's stock between October 20, 2017 and July 19, 2018 (the "Class Period"), against our

company and certain of its officers in the United States District Court for the Southern District of New York, case number 1:18-cv-8039. The complaint alleges that throughout the Class Period we made materially false statements or omissions of material fact regarding our sales growth and controlling expenses in an effort to artificially inflate the price of our stock for the personal gain of the Company's founding family. On October 17, 2018, a copycat case named Steven S. Fishman v. Skechers USA, Inc. et al. was filed with nearly identical allegations in the United States District Court for the Southern District of New York, 1:18-CV-09510. Given the early stages of these proceedings and the limited information available, we cannot predict the outcome of these legal proceeding or whether an adverse result in these case would have a material adverse impact on our operations or financial position. We believe we have meritorious defenses and intend to defend these matters vigorously.

Yolanda Zuniga v. Team One Employment Specialists, LLC, Skechers USA, Inc., Dolores Carte et al. – On December 20, 2017, our company was named as a defendant in an action filed by a former employee named Yolanda Zuniga in the Superior Court of California, County of Riverside, Case No. RIC 1723878, alleging discrimination, harassment, retaliation, violation of the Family Medical Leave Act/California Family Rights Act, breach of contract and wrongful termination, among other causes of action, and seeking compensatory damages, punitive and exemplary damages, and attorneys' fees. This case was stayed pending the outcome of an arbitration between the parties involving identical claims. Skechers believes it has meritorious defenses, vehemently denies the allegations and intends to defend this case vigorously. Notwithstanding, it is too early to predict the outcome of this legal proceeding or whether an adverse result in this case would have a material adverse impact on our operations or financial position.

Ealeen Wilk v. Skechers U.S.A., Inc. — On September 10, 2018, Ealeen Wilk filed a putative class action lawsuit against our company in the United States District Court for the Central District of California, Case No. 5:18-cv-01921, alleging violations of the California Labor Code, including unpaid overtime, unpaid wages due upon termination and unfair business practices. The complaint seeks actual, compensatory, special and general damages; penalties and liquidated damages; restitutionary and injunctive relief; attorneys' fees and costs; and interest as permitted by law. While it is too early to predict the outcome of the litigation or a reasonable range of potential losses and whether an adverse result would have a material adverse impact on our results of operations or financial position, we believe that we have meritorious defenses, vehemently deny the allegations, and intend to defend the case vigorously.

In addition to the matters included in its reserve for loss contingencies, we occasionally become involved in litigation arising from the normal course of business, and we are unable to determine the extent of any liability that may arise from any such unanticipated future litigation. We have no reason to believe that there is a reasonable possibility or a probability that we may incur a material loss, or a material loss in excess of a recorded accrual, with respect to any other such loss contingencies. However, the outcome of litigation is inherently uncertain and assessments and decisions on defense and settlement can change significantly in a short period of time. Therefore, although we consider the likelihood of such an outcome to be remote with respect to those matters for which we have not reserved an amount for loss contingencies, if one or more of these legal matters were resolved against our company in the same reporting period for amounts in excess of our expectations, our consolidated financial statements of a particular reporting period could be materially adversely affected.

#### ITEM 1A. RISK FACTORS

The information presented below updates the risk factors disclosed in our annual report on Form 10-K for the year ended December 31, 2017 and should be read in conjunction with the risk factors and other information disclosed in our 2017 annual report on Form 10 K that could have a material effect on our business, financial condition and results of operations.

Possible New Tariffs That Might Be Imposed By The United States Government Could Have A Material Adverse Effect On Our Results Of Operations.

Recently, the United States government announced tariffs on certain steel and aluminum products imported into the United States, which has resulted in reciprocal tariffs from the European Union on goods imported from the United States. In September 2018, the United States Government placed additional tariffs of approximately \$200 billion on goods imported from China. These tariffs, which took effect on September 25, 2018, initially have been set at a level of 10 percent until the end of the year, at which point the tariffs will rise to 25 percent. China has already imposed tariffs on a wide range of American products in retaliation for new tariffs on steel and aluminum. Additional tariffs could be imposed by China in response to the proposal to increase tariffs on products imported from China. The majority of our products that we sell in the United States are manufactured in China. There is also a concern that the imposition of additional tariffs by the United States could result in the adoption of additional tariffs by other countries as well. Any resulting escalation of trade tensions could have a significant, adverse effect on world trade and the world economy. While it is too early to predict whether or how the recently enacted tariffs will impact our business, the imposition of tariffs on footwear, apparel or other items imported by us from China could require us to increase prices to our customers or, if unable to do so, result in lowering our gross margin on products sold. Tariffs on footwear imported from China could have a material adverse effect on our business and results of operations.

### We Depend Upon A Relatively Small Group Of Customers For A Large Portion Of Our Sales.

During the nine months ended September 30, 2018 and 2017, our net sales to our five largest customers accounted for approximately 10.5% and 12.5% of total net sales, respectively. No customer accounted for more than 10.0% of outstanding accounts receivable balance at September 30, 2018 or December 31, 2017. Although we have long-term relationships with many of our customers, our customers do not have a contractual obligation to purchase our products and we cannot be certain that we will be able to retain our existing major customers. Furthermore, the retail industry regularly experiences consolidation, contractions and closings which may result in our loss of customers or our inability to collect accounts receivable of major customers. If we lose a major customer, experience a significant decrease in sales to a major customer or are unable to collect the accounts receivable of a major customer, our business could be harmed.

### We Rely On Independent Contract Manufacturers And, As A Result, Are Exposed To Potential Disruptions In Product Supply.

Our footwear products are currently manufactured by independent contract manufacturers. During the nine months ended September 30, 2018 and 2017, the top five manufacturers of our manufactured products produced approximately 41.9% and 49.8% of our total purchases, respectively. One manufacturer accounted for 11.3% of total purchases for the nine months ended September 30, 2018 and the same manufacturer accounted for 19.8% of total purchases for the same period in 2017. We do not have long-term contracts with manufacturers and we compete with other footwear companies for production facilities. We could experience difficulties with these manufacturers, including reductions in the availability of production capacity, failure to meet our quality control standards, failure to meet production deadlines or increased manufacturing costs. This could result in our customers canceling orders, refusing to accept deliveries or demanding reductions in purchase prices, any of which could have a negative impact on our cash flow and harm our business.

If our current manufacturers cease doing business with us, we could experience an interruption in the manufacture of our products. Although we believe that we could find alternative manufacturers, we may be unable to establish relationships with alternative manufacturers that will be as favorable as the relationships we have now. For example, new manufacturers may have higher prices, less favorable payment terms, lower manufacturing capacity, lower quality standards or higher lead times for delivery. If we are unable to provide products consistent with our standards or the manufacture of our footwear is delayed or becomes more expensive, our business would be harmed.

### One Principal Stockholder Is Able To Substantially Control All Matters Requiring Approval By Our Stockholders And Another Stockholder Is Able To Exert Significant Influence Over All Matters Requiring A Vote Of Our Stockholders, And Their Interests May Differ From The Interests Of Our Other Stockholders.

As of September 30, 2018, our Chairman of the Board and Chief Executive Officer, Robert Greenberg, beneficially owned 76.4% of our outstanding Class B common shares, members of Mr. Greenberg's immediate family beneficially owned an additional 14.0% of our outstanding Class B common shares, and Gil Schwartzberg, trustee of several trusts formed by Mr. Greenberg and his wife for estate planning purposes, beneficially owned 30.3% of our outstanding Class B common shares. The holders of Class A common shares and Class B common shares have identical rights except that holders of Class A common shares are entitled to one vote per share while holders of Class B common shares are entitled to ten votes per share on all matters submitted to a vote of our stockholders. As a result, as of September 30, 2018, Mr. Greenberg beneficially owned 35.5% of the aggregate number of votes eligible to be cast by our stockholders, and together with shares beneficially owned by other members of his immediate family, Mr. Greenberg and his immediate family beneficially owned 46.0% of the aggregate number of votes eligible to be cast by our stockholders, and Mr. Schwartzberg beneficially owned 19.5% of the aggregate number of votes eligible to be cast by our stockholders. Therefore, Messrs. Greenberg and Schwartzberg are each able to exert significant influence over,

all matters requiring approval by our stockholders. Matters that require the approval of our stockholders include the election of directors and the approval of mergers or other business combination transactions. Mr. Greenberg also has significant influence over our management and operations. As a result of such influence, certain transactions are not likely without the approval of Messrs. Greenberg and Schwartzberg, including proxy contests, tender offers, open market purchase programs or other transactions that can give our stockholders the opportunity to realize a premium over the then-prevailing market prices for their shares of our Class A common shares. Because Messrs. Greenberg's and Schwartzberg's interests may differ from the interests of the other stockholders, their ability to substantially control or significantly influence, respectively, actions requiring stockholder approval, may result in our company taking action that is not in the interests of all stockholders. The differential in the voting rights may also adversely affect the value of our Class A common shares to the extent that investors or any potential future purchaser view the superior voting rights of our Class B common shares to have value.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Recent Sales of Unregistered Securities: None.

(b) Use of Proceeds from Registered Securities: None.

(c) Issuer Purchases of Equity Securities

The table below summarizes the number of shares of our Class A Common Stock that were repurchased during the three months ended September 30, 2018.

Month Ended	Total Number of Shares Purchased (1) (2)	Average Price Paid Per Share	Total Number of Shares Purchased from Certain Employees (1)	Total Number of Shares Purchased under the Stock Repurchase Program (2)	Maximum Dollar Value of Shares that May Yet Be Purchased under the Program
July 31, 2018	223,938	\$ 27.73	—	223,938	\$ 125,791,000
August 31, 2018	821,475	\$ 29.12	3,852	817,623	101,980,000
September 30, 2018	369,077	\$ 27.42	4,047	365,030	91,973,000
Total	1,414,490	\$ 28.45	7,899	1,406,591	\$91,973,000

(1) The Company repurchased 7,899 shares from certain employees to facilitate income tax withholding payments pertaining to restricted stock awards that vested during the three months ended September 30, 2018. Such shares were not repurchased pursuant to a publicly announced plan or program.

(2) As announced on February 6, 2018, the Board of Directors of the Company has approved a stock repurchase program, authorizing the repurchase of up to an aggregate of \$150.0 million of the Company's Class A common stock. The program allows the Company to repurchase shares of Class A common stock from time to time for cash in the open market or privately negotiated transactions or other transactions, as market and business conditions warrant and subject to applicable legal requirements. The stock repurchase program does not obligate the Company to repurchase any particular amount of common stock, and it could be modified, suspended or discontinued at any time.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

None.

## ITEM 5. OTHER INFORMATION

On September 29, 2018, through a subsidiary of our Chinese joint venture ("the Subsidiary"), we entered into a 700 million yuan loan agreement with China Construction Bank Corporation ("the China DC Loan Agreement"). The proceeds from the China DC Loan Agreement will be used to finance the construction of our distribution center in China. Interest will be paid quarterly. The interest rate will float and be calculated at a reference rate provided by the

People's Bank of China. The interest rate may increase or decrease over the life of the loan, and will be evaluated every 12 months. The principal of the loan will be repaid in semi-annual installments, beginning in 2021, of variable amounts as specified in the China DC Loan Agreement. The China DC Loan Agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including covenants that limit the ability of the Subsidiary, to among other things, allow external investment to be added, pledge assets, issue debt with priority over the China DC Loan Agreement, and adjust the capital stock structure of the Subsidiary. The China DC Loan Agreement matures on September 28, 2023. The obligations of the Subsidiary under the China DC Loan Agreement are jointly and severally guaranteed by our Chinese joint venture. As of September 30, 2018 there was \$2.8 million outstanding under this credit facility, which is classified as short-term borrowings in our condensed consolidated balance sheets.

On October 19, 2018, through the Subsidiary, we entered into a 50 million yuan revolving loan agreement with China Construction Bank Corporation ("the China DC Revolving Loan Agreement"). The proceeds from the China DC Revolving Loan Agreement will be used to finance the construction and operation of our distribution center in China. Interest will be paid quarterly. The interest rate will be based upon the prime rate from the People's Bank of China less a discount. As specified in the China DC Revolving Loan Agreement, the entire principal balance of the loan will be repaid when the China DC Revolving Loan Agreement matures on October 18, 2019. The Subsidiary has the option to extend the China DC Revolving Agreement, conditioned upon the satisfaction of certain terms. The China DC Revolving Loan Agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including covenants that will limit the ability of the Subsidiary, to among other things, allow external investment to be added, pledge assets, issue debt with priority over the China DC Revolving Loan Agreement, and adjust the capital stock structure of the Subsidiary. The obligations of the Subsidiary under the China DC Revolving Loan Agreement are jointly and severally guaranteed by our Chinese joint venture.

ITEM 6. EXHIBITS

Exhibit

Number Description

- 10.1\*\* China DC Loan Agreement, dated September 29, 2018, between Skechers Taicang Trading and Logistics Co Limited, a wholly owned subsidiary of Skechers China Limited, which is a joint venture of the Registrant, and China Construction Bank Corporation, regarding distribution center in Taicang, China.
- 10.2 Mortgage Contract, dated August 28, 2018, between Skechers Taicang Trading and Logistics Co Limited, a wholly owned subsidiary of Skechers China Limited, which is a joint venture of the Registrant, and China Construction Bank Corporation, regarding distribution center in Taicang, China.
- 10.3 Guarantee Agreement, dated July 24, 2018, between Skechers Taicang Trading and Logistics Co Limited, a wholly owned subsidiary of Skechers China Limited, which is a joint venture of the Registrant, and China Construction Bank Corporation, regarding distribution center in Taicang, China.
- 10.4\*\* Cooperative Agreement on Close Management of Fixed Asset Loan Project, dated September 29, 2018, between Skechers Taicang Trading and Logistics Co Limited, a wholly owned subsidiary of Skechers China Limited, which is a joint venture of the Registrant, and China Construction Bank Corporation, regarding distribution center in Taicang, China.
- 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 of the Sarbanes-Oxley Act of 2002.
- 32.1\* Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

\*In accordance with Item 601(b)(32)(ii) of Regulation S-K, this exhibit shall not be deemed “filed” for the purposes of Section 18 of the Exchange Act or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act.

\*\*



The Company has applied with the Secretary of the Securities and Exchange Commission for confidential treatment of certain information pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended. The Company has filed separately with its application a copy of the exhibit including all confidential portions, which may be made available for public inspection pending the Securities and Exchange Commission's review of the application in accordance with Rule 24b-2.

SIGNATURES

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

Date: November 2, 2018 SKECHERS U.S.A., INC.

By: /s/ John Vandemore  
John Vandemore  
Chief Financial Officer