

Fossil Group, Inc.  
Form 10-Q  
August 10, 2017

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

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended: July 1, 2017

OR

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

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

Commission file number: 000-19848

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FOSSIL GROUP, INC.

(Exact name of registrant as specified in its charter)

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

901 S. Central Expressway, Richardson, Texas	75080
(Address of principal executive offices)	(Zip Code)
(972) 234-2525	
(Registrant's telephone number, including area code)	

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 (check one):  
Large accelerated filer  Accelerated filer

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Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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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 the registrant's common stock outstanding as of August 3, 2017: 48,521,969

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FOSSIL GROUP, INC.  
 FORM 10-Q  
 FOR THE FISCAL QUARTER ENDED JULY 1, 2017  
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## PART I—FINANCIAL INFORMATION

## Item 1. Financial Statements

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

	July 1, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$319,824	297,330
Accounts receivable - net of allowances of \$57,097 and \$79,707, respectively	240,401	375,520
Inventories	618,070	542,487
Prepaid expenses and other current assets	126,488	131,953
Total current assets	1,304,783	1,347,290
Property, plant and equipment - net of accumulated depreciation of \$440,155 and \$414,761, respectively	255,778	273,851
Goodwill	—	355,263
Intangible and other assets-net	215,411	210,493
Total long-term assets	471,189	839,607
Total assets	\$1,775,972	\$2,186,897
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$163,538	\$163,644
Short-term and current portion of long-term debt	32,719	26,368
Accrued expenses:		
Compensation	57,287	52,993
Royalties	17,957	30,062
Co-op advertising	17,536	29,111
Transaction taxes	28,536	26,743
Other	77,166	69,565
Income taxes payable	19,361	16,099
Total current liabilities	414,100	414,585
Long-term income taxes payable	19,064	18,584
Deferred income tax liabilities	507	55,877
Long-term debt	613,580	609,961
Other long-term liabilities	73,907	72,452
Total long-term liabilities	707,058	756,874
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Common stock, 48,511 and 48,269 shares issued and outstanding at July 1, 2017 and December 31, 2016, respectively	485	483
Additional paid-in capital	227,778	213,352
Retained earnings	494,927	887,825
Accumulated other comprehensive income (loss)	(80,161	) (95,424 )
Total Fossil Group, Inc. stockholders' equity	643,029	1,006,236
Noncontrolling interest	11,785	9,202

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Total stockholders' equity	654,814	1,015,438
Total liabilities and stockholders' equity	\$1,775,972	\$2,186,897

See notes to the unaudited condensed consolidated financial statements.

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

	For the 13 Weeks Ended July 1, 2017	For the 13 Weeks Ended July 2, 2016	For the 26 Weeks Ended July 1, 2017	For the 26 Weeks Ended July 2, 2016
Net sales	\$596,846	\$685,368	\$1,178,636	\$1,345,216
Cost of sales	295,499	329,618	587,771	641,129
Gross profit	301,347	355,750	590,865	704,087
Operating expenses:				
Selling, general and administrative expenses	314,210	340,300	622,707	674,233
Goodwill and trade name impairments	407,128	—	407,128	—
Restructuring charges	9,765	—	36,049	—
Total operating expenses	731,103	340,300	1,065,884	674,233
Operating income (loss)	(429,756 )	15,450	(475,019 )	29,854
Interest expense	11,641	6,421	20,025	12,420
Other income (expense) - net	2,002	2,542	7,640	4,812
Income (loss) before income taxes	(439,395 )	11,571	(487,404 )	22,246
Provision for income taxes	(96,296 )	3,499	(97,516 )	6,778
Net income (loss)	(343,099 )	8,072	(389,888 )	15,468
Less: Net income attributable to noncontrolling interest	1,613	2,051	3,010	3,654
Net income (loss) attributable to Fossil Group, Inc.	\$(344,712)	\$6,021	\$(392,898)	\$11,814
Other comprehensive income (loss), net of taxes:				
Currency translation adjustment	\$16,461	\$(9,500 )	\$26,856	\$7,721
Cash flow hedges - net change	(9,592 )	4,331	(11,593 )	(6,101 )
Pension plan activity	—	—	—	1,714
Total other comprehensive income (loss)	6,869	(5,169 )	15,263	3,334
Total comprehensive income (loss)	(336,230 )	2,903	(374,625 )	18,802
Less: Comprehensive income attributable to noncontrolling interest	1,613	2,051	3,010	3,654
Comprehensive income (loss) attributable to Fossil Group, Inc.	\$(337,843)	\$852	\$(377,635)	\$15,148
Earnings (loss) per share:				
Basic	\$(7.11 )	\$0.13	\$(8.12 )	\$0.25
Diluted	\$(7.11 )	\$0.12	\$(8.12 )	\$0.24
Weighted average common shares outstanding:				
Basic	48,484	48,119	48,399	48,125
Diluted	48,484	48,207	48,399	48,229

See notes to the unaudited condensed consolidated financial statements.

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

	For the 26 Weeks Ended July 1, 2017	For the 26 Weeks Ended July 2, 2016
<b>Operating Activities:</b>		
Net income (loss)	\$(389,888)	\$15,468
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization and accretion	42,085	49,666
Stock-based compensation	14,131	16,463
Decrease in allowance for returns-net of inventory in transit	(12,129 )	(15,473 )
Loss on disposal of assets	1,538	1,151
Fixed asset and other long-lived asset impairment losses	2,722	—
Goodwill and trade name impairment losses	407,128	—
Non-cash restructuring charges	4,420	—
Increase (decrease) in allowance for doubtful accounts	2,795	(4,841 )
Deferred income taxes and other	(100,272 )	(448 )
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	166,647	139,765
Inventories	(64,483 )	(41,107 )
Prepaid expenses and other current assets	(6,494 )	(8,656 )
Accounts payable	(1,836 )	(17,106 )
Accrued expenses	(28,259 )	(54,285 )
Income taxes payable	(2,715 )	(8,650 )
Net cash provided by operating activities	35,390	71,947
<b>Investing Activities:</b>		
Additions to property, plant and equipment	(12,788 )	(39,313 )
Decrease in intangible and other assets	676	786
Misfit working capital settlement	—	788
Proceeds from the sale of property, plant and equipment	25	1,955
Net investment hedge settlement	—	752
Net cash used in investing activities	(12,087 )	(35,032 )
<b>Financing Activities:</b>		
Acquisition of common stock	(907 )	(6,418 )
Distribution of noncontrolling interest earnings	(427 )	(4,544 )
Debt borrowings	766,048	424,800
Debt payments	(752,354 )	(498,848 )
Payment for shares of Fossil, S.L.	—	(8,657 )
Debt issuance costs and other	(5,896 )	62
Net cash provided by (used in) financing activities	6,464	(93,605 )
Effect of exchange rate changes on cash and cash equivalents	(7,273 )	(749 )
Net increase (decrease) in cash and cash equivalents	22,494	(57,439 )
<b>Cash and cash equivalents:</b>		
Beginning of period	297,330	289,275
End of period	\$319,824	\$231,836

See notes to the unaudited condensed consolidated financial statements.

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FOSSIL GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

1. FINANCIAL STATEMENT POLICIES

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

The condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary to present a fair statement of the Company's financial position as of July 1, 2017, and the results of operations for the thirteen-week periods ended July 1, 2017 ("Second Quarter") and July 2, 2016 ("Prior Year Quarter"), respectively, and the twenty-six week periods ended July 1, 2017 ("Year To Date Period") and July 2, 2016 ("Prior Year YTD Period"). All adjustments are of a normal, recurring nature.

These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Annual Report on Form 10-K filed by the Company pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), for the fiscal year ended December 31, 2016 (the "2016 Form 10-K"). Operating results for the Second Quarter are not necessarily indicative of the results to be achieved for the full fiscal year.

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the periods reported. Actual results could differ from those estimates. The Company has not made any changes in its significant accounting policies from those disclosed in the 2016 Form 10-K.

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

**Hedging Instruments.** The Company is exposed to certain market risks relating to foreign exchange rates and interest rates. The Company actively monitors and attempts to mitigate but does not eliminate these exposures using derivative instruments including foreign exchange forward contracts ("forward contracts") and interest rate swaps. The Company's foreign subsidiaries periodically enter into forward contracts to hedge the future payment of intercompany inventory transactions denominated in U.S. dollars. Additionally, the Company enters into forward contracts to manage fluctuations in Japanese yen exchange rates that will be used to settle future third-party inventory component purchases by a U.S. dollar functional currency subsidiary. If the Company was to settle its euro, Canadian dollar, British pound, Japanese yen, Mexican peso, Australian dollar and U.S dollar forward contracts as of July 1, 2017, the result would have been a net loss of approximately \$5.8 million, net of taxes. This unrealized loss is recognized in other comprehensive income (loss), net of taxes on the Company's consolidated statements of income (loss) and comprehensive income (loss). Additionally, to the extent that any of these contracts are not considered to be perfectly effective in offsetting the change in the value of the cash flows being hedged, any changes in fair value relating to the ineffective portion of these contracts would be recognized in other income (expense)-net on the Company's consolidated statements of income (loss) and comprehensive income (loss). Also, the Company has entered into an interest rate swap agreement to effectively convert portions of its variable rate debt obligations to a fixed rate. Changes in the fair value of the interest rate swap is recorded as a component of accumulated other comprehensive

income (loss) within stockholders' equity, and is recognized in interest expense in the period in which the payment is settled. To reduce exposure to changes in currency exchange rates adversely affecting the Company's investment in foreign currency-denominated subsidiaries, the Company periodically enters into forward contracts designated as net investment hedges. Both realized and unrealized gains and losses from net investment hedges are recognized in the cumulative translation adjustment component of other comprehensive income (loss), and will be reclassified into earnings in the event the Company's underlying investments are liquidated or disposed. The Company does not hold or issue derivative financial instruments for trading or speculative

purposes. See “Note 10—Derivatives and Risk Management” for additional disclosures about the Company’s use of derivatives.

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

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

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

For the	For the	For the	For the
13	13	26	26
Weeks	Weeks	Weeks	Weeks
Ended	Ended	Ended	Ended
July 1,	July 2,	July 1,	July 2,
2017	2016	2017	2016

Numerator: