

SKECHERS USA INC
Form 10-Q
August 05, 2016

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 June 30, 2016

OR

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

For the transition period from _____ to _____

Commission File Number 001-14429

SKECHERS U.S.A., INC.

(Exact name of registrant as specified in its charter)

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

THE NUMBER OF SHARES OF CLASS A COMMON STOCK OUTSTANDING AS OF AUGUST 1, 2016:
133,320,987.

THE NUMBER OF SHARES OF CLASS B COMMON STOCK OUTSTANDING AS OF AUGUST 1, 2016:
24,545,188.

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

FORM 10-Q

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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)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$628,827	\$507,991
Trade accounts receivable, less allowances of \$26,602 in 2016 and \$24,260 in 2015	468,572	343,930
Other receivables	20,545	18,661
Total receivables	489,117	362,591
Inventories	590,711	620,247
Prepaid expenses and other current assets	57,283	57,363
Total current assets	1,765,938	1,548,192
Property, plant and equipment, net	464,403	435,907
Deferred tax assets	17,680	17,825
Other assets	43,411	37,954
Total non-current assets	525,494	491,686
TOTAL ASSETS	\$2,291,432	\$2,039,878
LIABILITIES AND EQUITY		
Current liabilities:		
Current installments of long-term borrowings	\$1,775	\$15,653
Short-term borrowings	3,274	59
Accounts payable	534,180	473,983
Accrued expenses	71,661	87,318
Total current liabilities	610,890	577,013
Long-term borrowings, excluding current installments	68,053	68,942
Deferred tax liabilities	9,058	8,507
Other long-term liabilities	11,740	9,682
Total non-current liabilities	88,851	87,131
Total liabilities	699,741	664,144
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	127

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129,641 and 127,324 shares issued and outstanding at June 30, 2016

and December 31, 2015, respectively

Class B convertible common stock, \$0.001 par value; 75,000 shares

authorized; 24,545 and 26,278 shares issued and outstanding at

June 30, 2016 and December 31, 2015, respectively	24	26
Additional paid-in capital	404,421	386,156
Accumulated other comprehensive loss	(19,365)	(26,305)
Retained earnings	1,139,271	967,552
Skechers U.S.A., Inc. equity	1,524,481	1,327,556
Noncontrolling interests	67,210	48,178
Total stockholders' equity	1,591,691	1,375,734
TOTAL LIABILITIES AND EQUITY	\$2,291,432	\$2,039,878

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		Six Months Ended June	
	June 30, 2016	2015	30, 2016	2015
Net sales	\$877,810	\$800,464	\$1,856,604	\$1,568,461
Cost of sales	461,556	425,856	1,008,198	861,313
Gross profit	416,254	374,608	848,406	707,148
Royalty income	3,307	3,630	5,932	5,512
	419,561	378,238	854,338	712,660
Operating expenses:				
Selling	75,966	64,875	129,844	113,967
General and administrative	243,240	201,021	485,589	398,162
	319,206	265,896	615,433	512,129
Earnings from operations	100,355	112,342	238,905	200,531
Other income (expense):				
Interest income	319	157	585	344
Interest expense	(1,861)	(3,041)	(3,249)	(5,878)
Other, net	(2,604)	2,990	175	(1,771)
Total other income (expense)	(4,146)	106	(2,489)	(7,305)
Earnings before income tax expense	96,209	112,448	236,416	193,226
Income tax expense	12,200	25,383	42,768	44,503
Net earnings	84,009	87,065	193,648	148,723
Less: Net earnings attributable to non-controlling interests	9,902	7,283	21,929	12,861
Net earnings attributable to Skechers U.S.A., Inc.	\$74,107	\$79,782	\$171,719	\$135,862
Net earnings per share attributable to Skechers U.S.A., Inc.:				
Basic	\$0.48	\$0.52	\$1.12	\$0.89
Diluted	\$0.48	\$0.52	\$1.11	\$0.88
Weighted average shares used in calculating net earnings per share				

attributable to Skechers U.S.A, Inc.:

Basic	154,049	152,712	153,901	152,565
Diluted	155,023	154,027	154,912	153,778

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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net earnings	\$84,009	\$87,065	\$193,648	\$148,723
Other comprehensive income, net of tax:				
Gain (loss) on foreign currency translation adjustment	338	1,742	6,336	(2,879)
Comprehensive income	84,347	88,807	199,984	145,844
Less: Comprehensive income attributable to non-controlling				
interests	8,353	7,307	21,326	12,652
Comprehensive income attributable to Skechers U.S.A., Inc.	\$75,994	\$81,500	\$178,658	\$133,192

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)

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net earnings	\$ 193,648	\$ 148,723
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	30,555	27,676
Amortization of other assets	5,820	617
Provision for bad debts and returns	8,385	4,216
Non-cash share-based compensation	10,870	8,874
Deferred income taxes	692	2,215
Loss (gain) on non-current assets	557	(20)
Net foreign currency adjustments	(441)	—
(Increase) decrease in assets:		
Receivables	(130,707)	(166,970)
Inventories	33,789	(19,209)
Prepaid expenses and other current assets	(4,142)	4,997
Other assets	(3,867)	(8,223)
Increase (decrease) in liabilities:		
Accounts payable	54,213	75,679
Accrued expenses	(19,149)	8,368
Other long-term liabilities	2,059	—
Net cash provided by operating activities	182,282	86,943
Cash flows from investing activities:		
Capital expenditures	(55,034)	(33,004)
Intangible asset additions	—	(95)
Purchases of investments	(2,194)	(2,106)
Proceeds from sales of investments	131	105
Net cash used in investing activities	(57,097)	(35,100)
Cash flows from financing activities:		
Net proceeds from the issuances of common stock through the employee		
stock purchase plan	2,928	2,238
Payments on long-term debt	(14,768)	(5,599)
Proceeds from (payments on) short-term borrowings	3,232	(487)
Excess tax benefits from share-based compensation	4,469	2,656
Distributions to non-controlling interests of consolidated entity	(5,199)	(2,350)
Contributions from non-controlling interests of consolidated entity	2,905	485
Net cash used in financing activities	(6,433)	(3,057)

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Net increase in cash and cash equivalents	118,752	48,786
Effect of exchange rates on cash and cash equivalents	2,084	(1,569)
Cash and cash equivalents at beginning of the period	507,991	466,685
Cash and cash equivalents at end of the period	\$628,827	\$513,902
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$3,041	\$4,947
Income taxes, net	34,391	32,487

See accompanying notes to unaudited condensed consolidated financial statements.

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016 and 2015

(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, 2015.

The results of operations for the six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2016.

On August 21, 2015, the Company’s board of directors approved a three-for-one stock split, effected in the form of a stock dividend, of both the Company’s Class A and Class B common stock. The stock split was made on October 16, 2015 to stockholders of record at the close of business on October 2, 2015. All share numbers and per share amounts presented in the condensed consolidated financial statements reflect the three-for-one stock split.

Fair Value of Financial Instruments

The carrying amount of the Company’s financial instruments, which principally include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximates fair value because of the relatively short maturity of such instruments.

The carrying amount of the Company’s 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 2, Line of Credit, Short-Term and Long-Term Borrowings). 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 June 30, 2016 and December 31, 2015, the interest rate swap was a Level 2 derivative and was classified as other

long-term liabilities on the Company's condensed consolidated balance sheets.

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

The Company recognizes revenue on wholesale sales when products are shipped and the customer takes title and assumes risk of loss, collection of the relevant receivable is reasonably assured, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. This generally occurs at time of shipment. Wholesale sales, which include amounts billed for shipping and handling costs, are recognized net of allowances for estimated returns, sales allowances, discounts, and chargebacks. Allowances for estimated returns, discounts, and chargebacks are recorded when related revenue is recorded. Related costs paid to third-party shipping companies are recorded as cost of sales. The Company recognizes revenue from retail and e-commerce sales at the point of sale. Sales and value added taxes collected from retail customers are excluded from reported revenues.

Royalty income is earned from licensing arrangements. Upon signing a new licensing agreement, the Company receives up-front fees, which are generally characterized as prepaid royalties. These fees are initially deferred and recognized as revenue as earned. In addition, the Company receives royalty payments based on actual sales of the licensed products. Typically, at each quarter-end the Company receives correspondence from licensees indicating the actual sales for the period. This information is used to calculate and record the related royalties based on the terms of the agreement.

Recent Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-13, “Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” (“ASU 2016-13”) which requires measurement and recognition of expected versus incurred credit losses for financial assets held. ASU 2016-13 is effective for the Company’s annual and interim reporting periods beginning January 1, 2020, with early adoption permitted on January 1, 2019. The Company is currently evaluating the impact of this ASU on its consolidated financial statements; however at the current time the Company does not know what impact the adoption will have on its consolidated financial statements, financial condition or results of operations.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). The updated guidance changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The update to the standard is effective for the Company’s annual and interim reporting periods beginning January 1, 2017, with early adoption permitted. The Company is currently evaluating the impact of ASU 2016-09 on its consolidated financial statements; however at the current time the Company does not know what impact the adoption of ASU 2016-09 will have on its consolidated financial statements, financial condition or results of operations.

In March 2016, the FASB issued ASU No. 2016-08, “Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net).” This update provides clarifying guidance regarding the application of ASU 2014-09 when another party, along with the reporting entity, is involved in providing a good or a service to a customer. In these circumstances, an entity is required to determine whether the nature of its promise is to provide that good or service to the customer (that is, the entity is a principal) or to arrange for the good or service to be provided to the customer by the other party (that is, the entity is an agent). In April 2016, the FASB issued ASU No. 2016-10, “Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing,” which clarifies the identification of performance obligations and the licensing implementation guidance. In May 2016, the FASB issued ASU No. 2016-11, “Revenue Recognition and Derivatives and Hedging: Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 Emerging Issues Task Force Meeting (“EITF”),” which rescinds SEC paragraphs pursuant to SEC staff announcements. These rescissions include changes to topics pertaining to accounting for

shipping and handling fees and costs and accounting for consideration given by a vendor to a customer. In May 2016, the FASB also issued ASU No. 2016-12, "Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients," which provides clarifying guidance in certain narrow areas and adds some practical expedients. The effective dates for these ASU's are the same as the effective date for ASU No. 2014-09, for the Company's annual and interim periods beginning January 1, 2018. The Company is currently evaluating the impact of these ASU's on its consolidated financial statements; however at the current time the Company does not know what impact the adoption of these ASU's will have on its consolidated financial statements, financial condition or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). The new standard requires lessees to recognize most leases on the balance sheet, which will increase lessees' reported assets and liabilities. ASU 2016-02 is effective for the Company's annual and interim reporting periods beginning January 1, 2019. ASU 2016-02 mandates a modified retrospective transition method. The Company is currently evaluating the impact of ASU 2016-02 on its consolidated financial statements; however at the current time the Company does not know what impact the adoption of ASU 2016-02 will have on its consolidated financial statements, financial condition or results of operations.

In July 2015, the FASB issued ASU No 2015-11, “Inventory (Topic 330): Simplifying the Measurement of Inventory” (“ASU 2015-11”). ASU 2015-11 requires that inventory within the scope of this standard be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The amendments in this update do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. ASU 2015-11 will be effective for the Company’s annual and interim reporting periods beginning January 1, 2017, with early adoption permitted. The Company is currently evaluating the impact of ASU 2015-11 on its consolidated financial statements; however the Company does not expect that the adoption of ASU 2015-11 will have an impact on its consolidated financial statements, financial condition or results of operations.

In May 2014, the FASB issued ASU No. 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 is January 1, 2018, and there will be two methods of adoption allowed, either a full retrospective adoption or a modified retrospective adoption. The Company is currently evaluating the impact of ASC 606 on its consolidated financial statements; however at the current time the Company does not know what impact the new standard will have on revenue recognized and other accounting decisions in future periods, if any, nor what method of adoption will be selected if the impact is material.

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

The Company and its subsidiaries had \$2.0 million and \$4.0 million of outstanding letters of credit as of June 30, 2016 and December 31, 2015, respectively, and approximately \$3.3 million and \$0.1 million in short-term borrowings as of June 30, 2016 and December 31, 2015, respectively.

Long-term borrowings at June 30, 2016 and December 31, 2015 are as follows (in thousands):

	2016	2015
Note payable to banks, due in monthly installments of \$121.3		
(includes principal and interest), variable-rate interest at		
2.46% per annum, secured by property, balloon payment of		
\$63,692 due August 2020	\$68,787	\$69,515
Note payable to banks, due in monthly installments of \$483.9	—	13,886
(includes principal and interest), fixed-rate interest at 3.19%		
per annum, secured by property, balloon payment of \$11,670		

paid in full June 2016		
Note payable to TCF Equipment Finance, Inc., due in monthly		
installments of \$30.5, (includes principal and interest) fixed-		
rate interest at 5.24% per annum, maturity date of July 2019	1,041	1,194
Subtotal	69,828	84,595
Less current installments	1,775	15,653
Total long-term borrowings	\$68,053	\$68,942

The Company's long-term debt obligations contain both financial and non-financial covenants, including cross-default provisions. The Company is in compliance with its non-financial covenants, including any cross-default provisions, and financial covenants of its long-term borrowings as of June 30, 2016 and December 31, 2015.

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.

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, 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 effectively modifies interest rate risk exposure by converting the Company's floating-rate debt to a fixed-rate of 4.08% for the term of the New Loan, thus reducing the impact of interest-rate changes on future interest payments. 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 the Company's condensed consolidated statements of equity within non-controlling interests. The Company's objectives in using an interest rate derivative are to add stability to interest payments and to manage exposure to interest rate movements. 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.

By utilizing an interest rate swap, the Company is exposed to credit-related losses in the event that the counterparty fails to perform under the terms of the derivative contract. To mitigate this risk, the Company entered into derivative contracts with major financial institutions based upon credit ratings and other factors. The Company continually assesses the creditworthiness of its counterparties. As of June 30, 2016, all counterparties to the interest rate swap had performed in accordance with their contractual obligations.

On December 29, 2010, the Company entered into a Master Loan and Security Agreement (the "Master Agreement"), by and between the Company and Banc of America Leasing & Capital, LLC, and an Equipment Security Note (together with the Master Agreement, the "Loan Documents"), by and among the Company, Banc of America Leasing & Capital, LLC, and Bank of Utah, as

agent (“Agent”). The Company used the proceeds to refinance certain equipment already purchased and to purchase new equipment for use in the Rancho Belago distribution facility. Borrowings made pursuant to the Master Agreement may be in the form of one or more equipment security notes (each a “Note,” and, collectively, the “Notes”) up to a maximum limit of \$80.0 million and each for a term of 60 months. The First Note entered into on the same date as the Master Agreement represented a borrowing of approximately \$39.3 million (“the First Note”). Interest accrued at a fixed rate of 3.54% per annum on the First Note. The Company made the final payment on the First Note on December 29, 2015. On June 30, 2011, the Company entered into another Note agreement for approximately \$36.3 million (“the Second Note”). Interest accrued at a fixed rate of 3.19% per annum on the Second Note. The Company made the final payment on the Second Note on June 29, 2016.

(3) STOCKHOLDERS’ EQUITY

During the three months ended June 30, 2016, 682,408 shares of Class B common stock were converted into shares of Class A common stock. During the three months ended June 30, 2015, 2,456,730 shares of Class B common stock were converted into shares of Class A common stock. During the six months ended June 30, 2016, 1,733,270 shares of Class B common stock were converted into shares of Class A common stock. During the six months ended June 30, 2015, 3,223,296 shares of Class B common stock were converted into shares of Class A common stock.

The following table reconciles equity attributable to noncontrolling interests (in thousands):

	Six Months Ended June 30,	
	2016	2015
Non-controlling interests, beginning of period	\$48,178	\$58,858
Net earnings attributable to non-controlling		
interests	21,929	12,861
Foreign currency translation adjustment	(603)	(209)
Capital contributions from non-controlling		
interests	2,905	485
Capital distributions to non-controlling		
interests	(5,199)	(2,350)
Non-controlling interests, end of period	\$67,210	\$69,645

(4) NON-CONTROLLING INTERESTS

The Company has equity interests in several joint ventures that were established either to exclusively distribute the Company’s products primarily throughout Asia 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 2016 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):

	June 30,	December
HF Logistics-SKX, LLC	2016	31, 2015
Current assets	\$816	\$2,111
Non-current assets	111,298	113,928
Total assets	\$112,114	\$116,039
Current liabilities	\$2,544	\$2,461
Non-current liabilities	69,062	69,951
Total liabilities	\$71,606	\$72,412
	June 30,	December
Distribution joint ventures (1)	2016	31, 2015
Current assets	\$220,571	\$154,060
Non-current assets	42,113	34,782
Total assets	\$262,684	\$188,842
Current liabilities	\$99,879	\$68,198
Non-current liabilities	65	62
Total liabilities	\$99,944	\$68,260

(1) Distribution joint ventures include Skechers China Limited, Skechers Ltd. (Israel), Skechers Retail India Private Limited, Skechers South Asia Private Limited, Skechers Southeast Asia Limited, and Skechers Thailand Limited. The following is a summary of net earnings attributable to, distributions to and contributions from non-controlling interests (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net earnings attributable to non-controlling interests	\$9,902	\$7,283	\$21,929	\$12,861
Distributions to:				
HF Logistics-SKX, LLC	1,210	750	2,116	1,900
Skechers China Limited	—	450	3,083	450
Contributions from:				
India distribution joint ventures	—	485	2,905	485

(5) 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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Basic earnings per share				
Net earnings attributable to Skechers U.S.A., Inc.	\$74,107	\$79,782	\$171,719	\$135,862
Weighted average common shares outstanding	154,049	152,712	153,901	152,565
Basic earnings per share attributable to				
Skechers U.S.A., Inc.	\$0.48	\$0.52	\$1.12	\$0.89

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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Diluted earnings per share				
Net earnings attributable to Skechers U.S.A., Inc.	\$74,107	\$79,782	\$171,719	\$135,862
Weighted average common shares outstanding	154,049	152,712	153,901	152,565
Dilutive effect of nonvested shares	974	1,315	1,011	1,213
Weighted average common shares outstanding	155,023	154,027	154,912	153,778
Diluted earnings per share attributable to				
Skechers U.S.A., Inc.	\$0.48	\$0.52	\$1.11	\$0.88

(6) STOCK COMPENSATION

For stock-based awards, the Company recognized compensation expense based on the grant date fair value. Share-based compensation expense was \$6.2 million and \$4.5 million for the three months ended June 30, 2016 and 2015, respectively. Share-based compensation expense was \$10.9 million and \$8.9 million for the six months ended June 30, 2016 and 2015, respectively.

A summary of the status and changes of the Company's nonvested shares related to the 2007 Incentive Award Plan (the "2007 Plan"), as of and for the six months ended June 30, 2016 is presented below:

Shares	Weighted Average
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		Grant-Date Fair Value
Nonvested at December 31, 2015	2,725,500	\$ 15.77
Granted	1,434,000	31.75
Vested	(468,000)	9.88
Cancelled	(12,000)	17.47
Nonvested at June 30, 2016	3,679,500	22.74

As of June 30, 2016, there was \$68.3 million of unrecognized compensation cost related to nonvested common shares. The cost is expected to be amortized over a weighted average period of 2.4 years.

(7)INCOME TAXES

Income tax expense and the effective tax rate for the three and six months ended June 30, 2016 and 2015 were as follows (in thousands, except the effective tax rate):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Income tax expense	\$12,200	\$25,383	\$42,768	\$44,503
Effective tax rate	12.7 %	22.6 %	18.1 %	23.0 %

The tax provision for the three and six months ended June 30, 2016 and 2015 was 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 ongoing effective annual tax rate for the remainder of 2016 to be between 17% and 22%, which 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 generally significantly lower than the U.S. federal and state combined statutory rate of approximately 39%. For the three and six months ended June 30, 2016, the decrease in the effective tax rate was primarily due to an increase in the amount of projected foreign earnings for our China operations relative to projected domestic earnings as compared to the same period in the prior year.

As of June 30, 2016, the Company had approximately \$628.8 million in cash and cash equivalents, of which \$332.0 million, or 52.8%, was held outside the U.S. Of the \$332.0 million held by the Company's foreign subsidiaries, approximately \$70.3 million is available for repatriation to the U.S. without incurring U.S. income taxes and applicable foreign income and withholding taxes in excess of the amounts accrued in the Company's condensed consolidated financial statements. Under current applicable tax laws, if the Company chooses to repatriate some or all of the funds designated as indefinitely reinvested outside the U.S., the amount repatriated would be subject to U.S. income taxes and applicable foreign income and withholding taxes. The Company does not expect to repatriate any of the funds presently designated as indefinitely reinvested outside the U.S. As such, the Company did not provide for deferred income taxes on its accumulated undistributed earnings of the Company's foreign subsidiaries.

In November 2015, the FASB issued ASU No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes" ("ASU 2015-17"), which amends the guidance requiring companies to separate deferred income tax liabilities and assets into current and non-current amounts in a classified balance sheet. This accounting guidance simplifies the presentation of deferred income taxes, such that deferred tax liabilities and assets are classified as non-current in a classified balance sheet. ASU 2015-17 will be effective for annual and interim reporting periods beginning January 1, 2017, with early adoption permitted. In the first quarter of 2016, the Company early adopted ASU 2015-17 on a retrospective basis. For all periods presented, deferred income taxes are reported as "Deferred tax assets" or "Deferred tax liabilities" on the condensed consolidated balance sheets. Prior to adoption, the Company reported deferred income taxes in either "Deferred tax assets," "Other assets," or "Other long-term liabilities" on the condensed consolidated balance sheets, depending on whether the net current deferred income taxes and net non-current deferred income taxes were in an asset or liability position. The change in presentation as of December 31, 2015 resulted in a reduction of current deferred tax assets and non-current deferred tax liabilities, and an increase of non-current deferred tax assets. The adoption of ASU 2015-17 did not have a material impact on the Company's consolidated financial statements, financial condition or results of operations.

(8) BUSINESS AND CREDIT CONCENTRATIONS

The Company generates the majority of its sales in the United States; however, several of its products are sold into various foreign countries, which subjects the Company to the risks of doing business abroad. In addition, the Company operates in the footwear industry, 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 \$258.2 million and \$180.2 million before allowances for bad debts, sales returns and chargebacks at June 30, 2016 and December 31, 2015, respectively. Foreign accounts receivable, which in some cases are collateralized by letters of credit, were equal to \$237.0 million and \$188.0 million before allowance for bad debts, sales returns and chargebacks at June 30, 2016 and December 31, 2015, respectively. The Company's credit losses attributable to write-offs (recoveries) for the three months ended June 30, 2016 and 2015 were \$1.5 million and \$(0.4) million, respectively. The Company's credit losses attributable to write-offs for the six months ended June 30, 2016 and 2015 were \$4.0 million and \$0.7 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 \$945.3 million and \$773.5 million at June 30, 2016 and December 31, 2015, respectively.

The Company's net sales to its five largest customers accounted for approximately 11.8% and 15.9% of total net sales for the three months ended June 30, 2016 and 2015, respectively. The Company's net sales to its five largest customers accounted for approximately 12.7% and 16.3% of total net sales for the six months ended June 30, 2016 and 2015, respectively. No customer accounted for more than 10.0% of the Company's net sales during the three and six months ended June 30, 2016 and 2015. No customer accounted for more than 10.0% of trade receivables at June 30, 2016. As of December 31, 2015, one customer accounted for 10.6% of trade receivables.

The Company's top five manufacturers produced the following, as a percentage of total production, for the three and six months ended June 30, 2016 and 2015:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Manufacturer #1	25.1 %	32.8 %	25.6 %	33.5 %
Manufacturer #2	10.4 %	7.5 %	10.7 %	7.9 %
Manufacturer #3	8.9 %	7.4 %	9.6 %	7.2 %
Manufacturer #4	6.6 %	6.9 %	5.4 %	5.7 %
Manufacturer #5	5.0 %	3.5 %	4.2 %	3.9 %
	56.0 %	58.1 %	55.5 %	58.2 %

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 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.

(9) SEGMENT AND GEOGRAPHIC REPORTING INFORMATION

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 June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net sales:				
Domestic wholesale	\$320,498	\$338,646	\$680,768	\$659,975
International wholesale	303,432	241,872	723,467	527,443
Retail	253,880	219,946	452,369	381,043
Total	\$877,810	\$800,464	\$1,856,604	\$1,568,461

	Three Months Ended June 30,	Six Months Ended June 30,
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	2016	2015	2016	2015
Gross profit:				