

GUESS INC  
Form 10-Q  
September 06, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended August 4, 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: 1-11893

GUESS?, INC.

(Exact name of registrant as specified in its charter)

Delaware 95-3679695

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

1444 South Alameda Street  
Los Angeles, California 90021  
(Address of principal executive offices) (Zip Code)  
(213) 765-3100

(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, 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.

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) 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.

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

As of September 4, 2018, the registrant had 81,025,423 shares of Common Stock, \$.01 par value per share, outstanding.

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GUESS?, INC.

FORM 10-Q

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## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements.

## GUESS?, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

|  | Aug 4,<br>2018<br>(unaudited) | Feb 3,<br>2018 |
|--|-------------------------------|----------------|
| <b>ASSETS</b>  |                               |                |
| Current assets:  |                               |                |
| Cash and cash equivalents  | \$219,062                     | \$367,441      |
| Accounts receivable, net   | 283,375                       | 259,996        |
| Inventories  | 464,531                       | 428,304        |
| Other current assets   | 86,030                        | 52,964         |
| Total current assets   | 1,052,998                     | 1,108,705      |
| Property and equipment, net  | 288,740                       | 294,254        |
| Goodwill   | 37,299                        | 38,481         |
| Other intangible assets, net   | 7,642                         | 5,977          |
| Deferred tax assets  | 63,277                        | 68,386         |
| Restricted cash  | 372                           | 241            |
| Other assets   | 139,570                       | 139,590        |
|  | \$1,589,898                   | \$1,655,634    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                               |                |
| Current liabilities:   |                               |                |
| Current portion of capital lease obligations and borrowings  | \$3,504                       | \$2,845        |
| Accounts payable   | 279,053                       | 264,438        |
| Accrued expenses   | 187,332                       | 200,562        |
| Total current liabilities  | 469,889                       | 467,845        |
| Long-term debt and capital lease obligations   | 36,945                        | 39,196         |
| Deferred rent and lease incentives   | 81,652                        | 81,564         |
| Other long-term liabilities  | 130,380                       | 127,964        |
|  | 718,866                       | 716,569        |
| Redeemable noncontrolling interests  | 4,951                         | 5,590          |
| Commitments and contingencies (Note 12)  |                               |                |
| Stockholders' equity:  |                               |                |
| Preferred stock, \$.01 par value. Authorized 10,000,000 shares; no shares issued and outstanding   | —                             | —              |
| Common stock, \$.01 par value. Authorized 150,000,000 shares; issued 142,373,036 and 141,623,687 shares, outstanding 81,030,202 and 81,371,118 shares, as of August 4, 2018 and February 3, 2018, respectively | 810                           | 813            |
| Paid-in capital  | 510,550                       | 498,249        |
| Retained earnings  | 1,105,173                     | 1,132,173      |
| Accumulated other comprehensive loss   | (126,020 )                    | (93,062 )      |
| Treasury stock, 61,342,834 and 60,252,569 shares as of August 4, 2018 and February 3, 2018, respectively   | (638,644 )                    | (621,354 )     |
| Guess?, Inc. stockholders' equity  | 851,869                       | 916,819        |
| Nonredeemable noncontrolling interests   | 14,212                        | 16,656         |

|                            |             |             |
|----------------------------|-------------|-------------|
| Total stockholders' equity | 866,081     | 933,475     |
|                            | \$1,589,898 | \$1,655,634 |

See accompanying notes to condensed consolidated financial statements.

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## GUESS?, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)

(in thousands, except per share data)

(unaudited)

|  | Three Months Ended |                 | Six Months Ended |                 |
|--|--------------------|-----------------|------------------|-----------------|
|  | Aug 4,<br>2018     | Jul 29,<br>2017 | Aug 4,<br>2018   | Jul 29,<br>2017 |
| Product sales  | \$626,162          | \$551,794       | \$1,127,667      | \$990,114       |
| Net royalties  | 19,709             | 16,498          | 39,493           | 32,523          |
| Net revenue  | 645,871            | 568,292         | 1,167,160        | 1,022,637       |
| Cost of product sales  | 406,440            | 370,265         | 753,791          | 679,968         |
| Gross profit   | 239,431            | 198,027         | 413,369          | 342,669         |
| Selling, general and administrative expenses   | 204,569            | 173,007         | 402,788          | 339,862         |
| Net gains on lease terminations  | —                  | —               | (152)            | ) —             |
| Asset impairment charges   | 2,981              | 1,233           | 3,740            | 3,995           |
| Earnings (loss) from operations  | 31,881             | 23,787          | 6,993            | (1,188)         |
| Other income (expense):  |                    |                 |                  |                 |
| Interest expense   | (863)              | ) (544)         | (1,602)          | ) (958)         |
| Interest income  | 1,132              | 1,260           | 2,109            | 2,131           |
| Other income (expense), net  | 1,360              | (2,169)         | ) (1,254)        | ) (281)         |
|  | 1,629              | (1,453)         | ) (747)          | ) 892           |
| Earnings (loss) before income tax expense  | 33,510             | 22,334          | 6,246            | (296)           |
| Income tax expense   | 7,776              | 6,453           | 1,499            | 5,050           |
| Net earnings (loss)  | 25,734             | 15,881          | 4,747            | (5,346)         |
| Net earnings attributable to noncontrolling interests                                    | 204                | 662             | 438              | 728             |
| Net earnings (loss) attributable to Guess?, Inc.   | \$25,530           | \$15,219        | \$4,309          | \$(6,074)       |
| Net earnings (loss) per common share attributable to common stockholders (Note 3):       |                    |                 |                  |                 |
| Basic  | \$0.32             | \$0.18          | \$0.05           | \$(0.08)        |
| Diluted  | \$0.31             | \$0.18          | \$0.05           | \$(0.08)        |
| Weighted average common shares outstanding attributable to common stockholders (Note 3): |                    |                 |                  |                 |
| Basic  | 80,110             | 82,396          | 80,006           | 82,703          |
| Diluted  | 81,550             | 82,763          | 81,248           | 82,703          |
| Dividends declared per common share  | \$0.225            | \$0.225         | \$0.450          | \$0.450         |

See accompanying notes to condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE  
INCOME (LOSS)

(in thousands)

(unaudited)

|   | Three Months Ended |           | Six Months Ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | Aug 4,             | Jul 29,   | Aug 4,           | Jul 29,   |
|   | 2018               | 2017      | 2018             | 2017      |
| Net earnings (loss)   | \$25,734           | \$15,881  | \$4,747          | \$(5,346) |
| Other comprehensive income (loss) ("OCI"):                          |                    |           |                  |           |
| Foreign currency translation adjustment                             |                    |           |                  |           |
| Gains (losses) arising during the period                            | (22,953 )          | 44,037    | (47,525 )        | 56,872    |
| Derivative financial instruments designated as cash flow hedges     |                    |           |                  |           |
| Gains (losses) arising during the period                            | 4,675              | (15,535 ) | 12,167           | (15,089 ) |
| Less income tax effect  | (564 )             | 2,442     | (1,588 )         | 2,120     |
| Reclassification to net earnings (loss) for (gains) losses realized | 2,311              | (649 )    | 4,190            | (1,310 )  |
| Less income tax effect  | (279 )             | 43        | (542 )           | 128       |
| Defined benefit plans   |                    |           |                  |           |
| Foreign currency and other adjustments                              | (40 )              | (90 )     | 303              | (104 )    |
| Less income tax effect  | 6                  | 8         | (26 )            | 9         |
| Net actuarial loss amortization                                     | 151                | 111       | 303              | 228       |
| Prior service credit amortization                                   | (7 )               | (6 )      | (14 )            | (13 )     |
| Less income tax effect  | (19 )              | (20 )     | (39 )            | (41 )     |
| Total comprehensive income (loss)                                   | 9,015              | 46,222    | (28,024 )        | 37,454    |
| Less comprehensive income attributable to noncontrolling interests: |                    |           |                  |           |
| Net earnings  | 204                | 662       | 438              | 728       |
| Foreign currency translation adjustment                             | 511                | 958       | 187              | 2,320     |
| Amounts attributable to noncontrolling interests                    | 715                | 1,620     | 625              | 3,048     |
| Comprehensive income (loss) attributable to Guess?, Inc.            | \$8,300            | \$44,602  | \$(28,649)       | \$34,406  |

See accompanying notes to condensed consolidated financial statements.

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GUESS?, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands)  
 (unaudited)

|  | Six Months Ended |                 |
|--|------------------|-----------------|
|  | Aug 4,<br>2018   | Jul 29,<br>2017 |
| Cash flows from operating activities:  |                  |                 |
| Net earnings (loss)  | \$4,747          | \$(5,346 )      |
| Adjustments to reconcile net earnings (loss) to net cash used in operating activities: |                  |                 |
| Depreciation and amortization of property and equipment                                | 31,195           | 29,802          |
| Amortization of other long-term and intangible assets                                  | 1,850            | 783             |
| Share-based compensation expense   | 7,989            | 8,150           |
| Unrealized forward contract (gains) losses   | (2,365 )         | 5,063           |
| Net loss on disposition of property and equipment and long-term assets                 | 4,125            | 3,717           |
| Other items, net   | 10,467           | (5,734 )        |
| Changes in operating assets and liabilities:   |                  |                 |
| Accounts receivable  | (967 )           | 4,246           |
| Inventories  | (71,044 )        | (47,419 )       |
| Prepaid expenses and other assets  | (20,971 )        | (2,606 )        |
| Accounts payable and accrued expenses  | 6,210            | 3,158           |
| Deferred rent and lease incentives   | 2,396            | 1,657           |
| Other long-term liabilities  | 4,716            | (5,136 )        |
| Net cash used in operating activities  | (21,652 )        | (9,665 )        |
| Cash flows from investing activities:  |                  |                 |
| Purchases of property and equipment  | (46,006 )        | (39,591 )       |
| Changes in other assets  | —                | (553 )          |
| Acquisition of businesses, net of cash acquired  | (6,321 )         | (175 )          |
| Net cash settlement of forward contracts   | 685              | 1,279           |
| Purchases of investments   | (1,581 )         | (497 )          |
| Net cash used in investing activities  | (53,223 )        | (39,537 )       |
| Cash flows from financing activities:  |                  |                 |
| Proceeds from borrowings   | —                | 166             |
| Repayment of capital lease obligations and borrowings                                  | (1,181 )         | (453 )          |
| Dividends paid   | (36,625 )        | (37,790 )       |
| Noncontrolling interest capital contribution   | —                | 962             |
| Issuance of common stock, net of tax withholdings on vesting of stock awards           | 4,634            | (149 )          |
| Purchase of treasury stock   | (23,620 )        | (17,827 )       |
| Net cash used in financing activities  | (56,792 )        | (55,091 )       |
| Effect of exchange rates on cash, cash equivalents and restricted cash                 | (16,581 )        | 24,444          |
| Net change in cash, cash equivalents and restricted cash                               | (148,248 )       | (79,849 )       |
| Cash, cash equivalents and restricted cash at the beginning of the year                | 367,682          | 397,650         |
| Cash, cash equivalents and restricted cash at the end of the period                    | \$219,434        | \$317,801       |
| Supplemental cash flow data:   |                  |                 |
| Interest paid  | \$683            | \$536           |
| Income taxes paid  | \$21,436         | \$13,222        |
| Non-cash investing and financing activity:   |                  |                 |



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|   |         |          |
|---|---------|----------|
| Assets acquired under capital lease obligations | \$1,164 | \$17,522 |
| Noncontrolling interest capital distributions   | \$3,069 | \$—      |

See accompanying notes to condensed consolidated financial statements.

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GUESS?, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

August 4, 2018

(unaudited)

(1) Basis of Presentation and New Accounting Guidance

Description of the Business

Guess?, Inc. (the “Company” or “GUESS?”) designs, markets, distributes and licenses a leading lifestyle collection of contemporary apparel and accessories for men, women and children that reflect the American lifestyle and European fashion sensibilities. The Company’s designs are sold in GUESS? owned stores, to a network of wholesale accounts that includes better department stores, selected specialty retailers and upscale boutiques and through the Internet. GUESS? branded products, some of which are produced under license, are also sold internationally through a series of retail store licensees and wholesale distributors.

Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements of the Company contain all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the condensed consolidated balance sheets as of August 4, 2018 and February 3, 2018, the condensed consolidated statements of income (loss) and comprehensive income (loss) for the three and six months ended August 4, 2018 and July 29, 2017 and the condensed consolidated statements of cash flows for the six months ended August 4, 2018 and July 29, 2017. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (“GAAP”) for interim financial information and the instructions to Rule 10-01 of Regulation S-X of the Securities and Exchange Commission. Accordingly, they have been condensed and do not include all of the information and footnotes required by GAAP for complete financial statements. The results of operations for the three and six months ended August 4, 2018 are not necessarily indicative of the results of operations to be expected for the full fiscal year. These financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended February 3, 2018. The three and six months ended August 4, 2018 had the same number of days as the three and six months ended July 29, 2017. All references herein to “fiscal 2019,” “fiscal 2018” and “fiscal 2017” represent the results of the 52-week fiscal year ending February 2, 2019, the 53-week fiscal year ended February 3, 2018 and the 52-week fiscal year ended January 28, 2017, respectively.

Reclassifications

The Company has made certain reclassifications to prior year amounts to conform to the current period presentation within the accompanying notes to the condensed consolidated financial statements.

Net Gains on Lease Terminations

During the six months ended August 4, 2018, the Company recorded net gains on lease terminations of approximately \$0.2 million related primarily to the early termination of certain lease agreements in North America. The net gains on lease terminations were recorded during the three months ended May 5, 2018. There were no net gains on lease terminations during the three or six months ended July 29, 2017.

New Accounting Guidance

Changes in Accounting Policies

In May 2014, the Financial Accounting Standards Board (“FASB”) issued a comprehensive new revenue recognition standard which superseded previous existing revenue recognition guidance. The standard is intended to clarify the principles of recognizing revenue and create common revenue recognition guidance between GAAP and International Financial Reporting Standards. The standard also requires expanded disclosures surrounding revenue recognition. During fiscal 2017, the FASB issued additional clarification guidance on the new revenue recognition standard which also included certain scope improvements and practical expedients. The Company

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adopted this guidance (including clarification guidance issued) effective February 4, 2018 using the modified retrospective method and, as a result, recorded a cumulative adjustment to increase retained earnings by approximately \$5.8 million, net of taxes. The adjustment related primarily to changes in the presentation of advertising contributions received from the Company's licensees and the related advertising expenditures incurred by the Company. Under previous guidance, the Company recorded advertising contributions received from its licensees and the related advertising expenditures incurred by the Company on a net basis in its consolidated balance sheet. To the extent that the advertising contributions exceeded the Company's advertising expenditures for its licensees, the excess contribution was treated as a deferred liability and was included in accrued expenses in the Company's consolidated balance sheet. Under the new revenue recognition standard, advertising contributions and related advertising expenditures related to the Company's licensing business are recorded on a gross basis in the Company's condensed consolidated statements of income (loss). This change resulted in an increase to net revenue and selling, general, and administrative ("SG&A") expenses of \$2.1 million and \$1.5 million, respectively, during the three months ended August 4, 2018 compared to the same prior-year period. During the six months ended August 4, 2018, this change resulted in an increase to net revenue and SG&A expenses of \$4.4 million and \$4.8 million, respectively, compared to the same prior-year period. Other minor differences related to the timing of revenue recognition from the Company's e-commerce operations, which are now recognized when merchandise is transferred to a common carrier rather than upon receipt by the customer, and a minimal change in the valuation of the amount that is deferred related to points earned under the Company's loyalty programs. Additionally, allowances for wholesale sales returns and wholesale markdowns are now presented as accrued expenses rather than as reductions to accounts receivable and the estimated cost associated with the allowance for sales returns is presented within other current assets rather than included in inventories in the Company's consolidated balance sheet. Refer to Note 2 for the Company's expanded disclosures on revenue recognition.

In January 2016, the FASB issued authoritative guidance which requires equity investments not accounted for under the equity method of accounting or consolidation accounting to be measured at fair value, with subsequent changes in fair value recognized in net income. In February 2018, the FASB issued additional clarification guidance which made targeted improvements to address certain aspects of recognition, measurement, presentation and disclosure requirements for financial instruments. The Company adopted this guidance (including the clarification guidance) effective February 4, 2018. The adoption of this guidance did not result in a cumulative-effect adjustment as of the beginning of the current year and did not have a material impact on the Company's consolidated financial statements or related disclosures.

In October 2016, the FASB issued authoritative guidance which amends the accounting for income taxes on intra-entity transfers of assets other than inventory. This guidance requires that entities recognize the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The income tax consequences on intra-entity transfers of inventory will continue to be deferred until the inventory has been sold to a third party. The Company adopted this guidance effective February 4, 2018. The adoption of this guidance did not have an impact on the Company's consolidated financial statements or related disclosures.

In March 2017, the FASB issued authoritative guidance related to the presentation of net periodic pension cost in the income statement. This guidance requires that the service cost component of net periodic pension cost be presented in the same line as other compensation costs arising from services rendered by the employees during the period. The other non-service components of net periodic pension cost are required to be presented in the income statement separately from the service cost component and outside of earnings from operations. This guidance also allows for the service cost component to be eligible for capitalization when applicable. The Company adopted this guidance effective February 4, 2018 on a retrospective basis for the presentation of the service cost component and other non-service components of net periodic pension cost in the income statement and on a prospective basis for capitalization of the service cost component. As a result, the Company reclassified \$0.5 million and \$1.1 million from SG&A expenses to other income (expense) during the three and six months ended July 29, 2017, respectively, which resulted in a related improvement in operating earnings (loss) during each of the respective periods. Other than the change in presentation of other non-service components of net periodic



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pension cost within the Company's consolidated statements of income (loss), the adoption of this guidance did not have an impact on the Company's consolidated financial statements and related disclosures.

In May 2017, the FASB issued authoritative guidance that provides clarification on accounting for modifications in share-based payment awards. The Company adopted this guidance effective February 4, 2018. The adoption of this guidance did not have an impact on the Company's consolidated financial statements or related disclosures.

In June 2018, the FASB issued authoritative guidance that expanded the scope of ASC Topic 718, Compensation - Stock Compensation, to include nonemployee share-based payment transactions. The Company early adopted this guidance during the second quarter of fiscal 2019. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements or related disclosures.

Recently Issued Accounting Guidance

In February 2016, the FASB issued a comprehensive new lease standard which will supersede previous lease guidance. The standard requires a lessee to recognize assets and liabilities related to long-term leases that were classified as operating leases under previous guidance in its balance sheet. An asset would be recognized related to the right to use the underlying asset and a liability would be recognized related to the obligation to make lease payments over the term of the lease. The standard also requires expanded disclosures surrounding leases. The standard (including clarification guidance issued during fiscal 2019) is effective for fiscal periods beginning after December 15, 2018, which will be the Company's first quarter of fiscal 2020, with early adoption permitted. The Company has completed the design phase of its selected lease management system and is in the process of completing its inventory of its lease contracts as well as implementing processes and controls to enable the preparation of the required financial information for this standard. The Company will apply this guidance retrospectively at the beginning of the period of adoption through a cumulative-effect adjustment to retained earnings and expects that this guidance will result in material increases in assets and liabilities in its consolidated balance sheet as well as enhanced disclosures.

In June 2016, the FASB issued authoritative guidance related to the measurement of credit losses on financial instruments. This guidance is effective for fiscal years beginning after December 15, 2019, which will be the Company's first quarter of fiscal 2021. Early adoption is permitted for fiscal periods beginning after December 15, 2018, which will be the Company's first quarter of fiscal 2020. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued authoritative guidance to simplify the testing for goodwill impairment by removing step two from the goodwill testing. Under current guidance, if the fair value of a reporting unit is lower than its carrying amount (step one), an entity would calculate an impairment charge by comparing the implied fair value of goodwill with its carrying amount (step two). The implied fair value of goodwill was calculated by deducting the fair value of the assets and liabilities of the respective reporting unit from the reporting unit's fair value as determined under step one. This guidance instead provides that an impairment charge should be recognized based on the difference between a reporting unit's fair value and its carrying value. This guidance also does not require a qualitative test to be performed on reporting units with zero or negative carrying amounts. However, entities need to disclose any reporting units with zero or negative carrying amounts that have goodwill and the amount of goodwill allocated to each. This guidance is effective for fiscal years beginning after December 15, 2019, which will be the Company's first quarter of fiscal 2021, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements or related disclosures.

In August 2017, the FASB issued authoritative guidance to better align the results of hedge accounting with an entity's risk management activities. This guidance updates the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results in the financial statements. This guidance is effective for fiscal years beginning after December 15, 2018, which will be the Company's first quarter of fiscal 2020, and requires a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption, with early adoption permitted. The updated presentation and disclosure guidance is required only on a

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prospective basis. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements or related disclosures.

In August 2018, the FASB issued authoritative guidance to modify the disclosure requirements on fair value measurements in ASC 820, Fair Value Measurement. This guidance is effective for fiscal years beginning after December 15, 2019, which will be the Company's first quarter of fiscal 2021, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its related disclosures.

In August 2018, the FASB issued authoritative guidance to modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance is effective for fiscal years beginning after December 15, 2020, which will be the Company's first quarter of fiscal 2022, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its related disclosures.

In August 2018, the FASB issued authoritative guidance to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The guidance provides criteria for determining which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The capitalized implementation costs are required to be expensed over the term of the hosting arrangement. The guidance also clarifies the presentation requirements for reporting such costs in the entity's financial statements. This guidance is effective for fiscal years beginning after December 15, 2019, which will be the Company's first quarter of fiscal 2021, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements and related disclosures.

**(2) Revenue Recognition****Significant Accounting Policies and Practices****Products Transferred at a Point in Time**

The Company recognizes the majority of its revenue from its direct-to-consumer (brick-and-mortar retail stores and concessions as well as e-commerce) and wholesale distribution channels at a point in time when it satisfies a performance obligation and transfers control of the product to the respective customer. For the Company's brick-and-mortar retail stores and concessions, revenue is typically recognized at the point of sale. Revenue generated from the Company's e-commerce sites is recognized when merchandise is transferred to a common carrier. This is a change compared to the Company's treatment under previous guidance where revenue from the Company's e-commerce sites was recognized based on the estimated customer receipt date. This change had an immaterial impact on revenue for the three and six months ended August 4, 2018. Revenue generated from the Company's wholesale distribution channel is recognized when control transfers to the customer, which generally occurs upon shipment. The amount of revenue that is recognized is based on the transaction price, which represents the invoiced amount and includes estimates of variable consideration such as allowances for sales returns, markdowns and loyalty award obligations, where applicable. The amount of variable consideration included in the transaction price may be constrained and is included only to the extent that it is probable that a significant reversal in the amount of the cumulative revenue recognized under the contract will not occur in a future period.

The Company accepts payments at its brick-and-mortar retail locations and its e-commerce sites in the form of cash, credit cards, gift cards and loyalty points, where applicable. Payment terms, typically less than one year, are offered to the Company's wholesale customers and do not include a significant financing component. The Company extends credit to wholesale customers based upon an evaluation of the customer's financial condition and credit history and generally requires no collateral but does obtain credit insurance when considered appropriate. As of August 4, 2018, approximately 52% of the Company's total net trade receivables and 62% of its European net trade receivables were subject to credit insurance coverage, certain bank guarantees or letters of credit for collection purposes. The Company's credit insurance coverage contains certain terms and conditions specifying

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deductibles and annual claim limits. The Company maintains allowances for doubtful accounts for estimated losses that result from the inability of its wholesale customers to make their required payments. The Company bases its allowances on analysis of the aging of accounts receivable at the date of the financial statements, assessments of historical and current collection trends, an evaluation of the impact of current economic conditions and whether the Company has obtained credit insurance or other guarantees. Management performs regular evaluations concerning the ability of its customers to satisfy their obligations and records a provision for doubtful accounts based on these evaluations. The Company's credit losses for the periods presented were immaterial and did not significantly exceed management's estimates. Refer to Note 5 for further information regarding the Company's allowance for doubtful accounts.

Shipping and handling costs associated with outbound freight incurred to transfer a product to a customer are accounted for as fulfillment costs and are included in SG&A expenses. Sales and usage-based taxes collected from customers and remitted directly to governmental authorities are excluded from net revenues. This is consistent with the presentation of such amounts in previous years.

The Company does not have significant contract balances related to its direct-to-consumer or wholesale distribution channels other than the allowance for sales returns and markdowns as well as liabilities related to its gift cards and loyalty programs. The Company also does not have significant contract acquisition costs related to its direct-to-consumer or wholesale distribution channels.

**Sales Return Allowances**

The Company accrues for estimated sales returns in the period in which the related revenue is recognized. To recognize the financial impact of sales returns, the Company estimates the amount of goods that will be returned based on historical experience and current trends and reduces sales and cost of sales accordingly. The Company's policy allows retail customers in certain regions a grace period to return merchandise following the date of sale. Substantially all of these returns are considered to be resalable at a price that exceeds the cost of the merchandise. The Company adopted the new revenue recognition standard effective as of the first quarter of fiscal 2019, and accordingly, has included the allowance for sales returns in accrued expenses and the estimated cost associated with such sales returns within other current assets in its condensed consolidated balance sheet. Prior to the adoption of the new revenue recognition standard, the Company recorded the allowance for wholesale sales returns against accounts receivable and the estimated cost of inventory associated with the allowance for sales returns in inventories. The allowance for retail sales returns was included in accrued expenses which is consistent with the current presentation. As of August 4, 2018, the Company included \$27.0 million in accrued expenses related to the allowance for sales returns and \$11.6 million in other current assets related to the estimated cost of such sales returns. As of February 3, 2018, the Company included \$25.0 million and \$2.9 million in accounts receivable and accrued expenses, respectively, related to the allowance for sales returns and \$11.9 million in inventories related to the estimated cost of such sales returns.

**Markdown Allowances**

Costs associated with customer markdowns are recorded as a reduction to revenues and any amounts unapplied to existing receivables are included in accrued expenses. These markdown allowances resulted from seasonal negotiations with the Company's wholesale customers, as well as historical trends and the evaluation of the impact of current economic conditions. The Company adopted the new revenue recognition standard effective as of the first quarter of fiscal 2019, and accordingly, has included the allowance for markdowns in accrued expenses in its condensed consolidated balance sheet. As of August 4, 2018, the Company included \$10.8 million in accrued expenses related to the allowance for markdowns. As of February 3, 2018, the Company included \$10.8 million in accounts receivable related to the allowance for markdowns.

**Gift Cards**

Gift card breakage is income recognized due to the non-redemption of a portion of gift cards sold by the Company for which a liability was recorded in prior periods. Gifts cards are mainly used in the U.S. and Canada. The Company issues its gift cards in the U.S. and Canada through one of its subsidiaries and is not required by law to escheat the value of unredeemed gift cards to the state in which the subsidiary is domiciled. Estimated





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breakage amounts are accounted for under the redemption recognition method and are classified as additional net revenues as the gift cards are redeemed. The Company's gift card breakage rate is approximately 6.1% and 5.1% for the U.S. retail business and Canadian retail business, respectively, based upon historical redemption patterns, which represents the cumulative estimated amount of gift card breakage from the inception of the electronic gift card program in late 2002. Based upon historical redemption trends, the Company recognizes estimated gift card breakage as a component of net revenue in proportion to actual gift card redemptions, over the period that remaining gift card values are redeemed. Any future revisions to the estimated breakage rate may result in changes in the amount of breakage income recognized in future periods. There have been no changes to the Company's accounting for gift card breakage upon adoption of the new revenue recognition standard effective as of the first quarter of fiscal 2019. During the three and six months ended August 4, 2018, the Company recognized \$0.1 million and \$0.2 million, respectively, of gift card breakage to revenue. During the three and six months ended July 29, 2017, the Company recognized \$0.1 million and \$0.2 million, respectively, of gift card breakage to revenue. As of August 4, 2018 and February 3, 2018, the Company included \$4.6 million and \$5.2 million in accrued expenses related to its gift card liability, respectively.

Loyalty Programs

The Company has customer loyalty programs in North America, Europe and Asia which cover all of its brands. Under certain of the programs, primarily in the U.S. and Canada, customers accumulate points based on purchase activity. Once a loyalty program member achieves a certain point level, the member earns awards that may only be redeemed for merchandise. Unredeemed points generally expire after six months without additional purchase activity and unredeemed awards generally expire after two months. Where applicable, the Company allocates a portion of the transaction price from sales in its direct-to-consumer channel to its loyalty program by using historical redemption rates to estimate the value of future award redemptions. This amount is accrued in current liabilities and recorded as a reduction of net revenue in the period which the related revenue is recognized. During the three months ended August 4, 2018, activity related to the Company's loyalty programs had a minimal impact on net revenue. During the six months ended August 4, 2018, activity related to the Company's loyalty programs decreased net revenue by \$0.4 million. During the three and six months ended July 29, 2017, activity related to the Company's loyalty programs increased net revenue by \$0.2 million and \$0.5 million, respectively. The aggregate dollar value of the loyalty program accruals included accrued expense was \$4.4 million and \$3.8 million as of August 4, 2018 and February 3, 2018, respectively. Future revisions to the estimated liability may result in changes to net revenue.

Intellectual Property Transferred Over Time

The Company's trademark license agreements represent symbolic licenses that are dependent on the Company's continued support over the term of the license agreement. The amount of revenue that is recognized from the licensing arrangements is based on sales-based royalty and advertising fund contributions as well as specific fixed payments, where applicable.

The typical license agreement requires that the licensee pay the Company the greater of a royalty based on a percentage of the licensee's net sales of licensed products or a guaranteed annual minimum royalty that typically increases over the term of the license agreement. Generally, licensees are also required to make contributions to advertising funds, as a percentage of their sales, over the term of the licensing agreement, and may elect to make additional contributions to support specific brand-building initiatives. The Company recognizes revenue from sales-based royalty and advertising fund contributions when the related sales occur which is consistent with the timing of when the performance obligation is satisfied. The Company adopted the new revenue recognition standard effective as of the first quarter of fiscal 2019, and accordingly, has recorded advertising contributions in revenue on a gross basis separate from any related advertising expenditures made by the Company which are recorded in SG&A expenses in the Company's condensed consolidated statements of income (loss). Prior to the adoption of the new revenue recognition standard, the Company recorded advertising contributions received from its licensees and the related advertising expenditures incurred by the Company on a net basis in its consolidated balance sheet. Under previous guidance, to the extent that the advertising contributions exceed the Company's advertising expenditures for its licensees, the excess contribution was treated as a deferred liability and was



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included in accrued expenses in the Company's condensed consolidated balance sheet. Refer to Note 1 for detail regarding the impact of this change on the Company's condensed consolidated balance sheet and its condensed consolidated statements of income (loss) as a result of the adoption of the new revenue recognition standard. The Company records royalty and advertising payments received on the Company's purchases of licensed product as a reduction of the cost of the licensed product.

The Company's trademark license agreements customarily provide for a multi-year initial term ranging from three to ten years, and may contain options to renew prior to expiration for an additional multi-year period. Several of the Company's key license agreements provide for specified, fixed payments over and above the normal, ongoing royalty payments in consideration of the grant of the license rights. These payments are recognized ratably as revenue over the term of the license agreement and do not include a significant financing component. The unrecognized portion of upfront payments is included in deferred royalties in accrued expenses and other long-term liabilities depending on the short or long-term nature of the payments to be recognized. As of August 4, 2018, the Company had \$7.3 million and \$16.5 million of deferred royalties related to these upfront payments included in accrued expenses and other long-term liabilities, respectively. This compares to \$6.8 million and \$12.8 million of deferred royalties related to these upfront payments included in accrued expenses and other long-term liabilities, respectively, at February 3, 2018. During the three and six months ended August 4, 2018, the Company recognized \$3.6 million and \$6.9 million in net royalties related to the amortization of the deferred royalties, respectively. During the three and six months ended July 29, 2017, the Company recognized \$3.0 million and \$6.0 million in net royalties related to the amortization of the deferred royalties, respectively.

Contract balances related to the Company's licensing distribution channel consist primarily of royalty receivables and liabilities related to deferred royalties. Refer to Note 5 for further information on royalty receivables. The Company does not have significant contract acquisition costs related to its licensing operations.

Refer to Note 8 for further information on disaggregation of revenue by segment and country.

**(3) Earnings (Loss) Per Share**

Basic earnings (loss) per share represents net earnings (loss) attributable to common stockholders divided by the weighted average number of common shares outstanding during the period. The Company considers any restricted stock units with forfeitable dividend rights that are issued and outstanding, but considered contingently returnable if certain service conditions are not met, as common equivalent shares outstanding. These restricted stock units are excluded from the weighted average number of common shares outstanding and basic earnings (loss) per share calculation until the respective service conditions have been met. Diluted earnings per share represent net earnings attributable to common stockholders divided by the weighted average number of common shares outstanding, inclusive of the dilutive impact of common equivalent shares outstanding during the period. The potentially dilutive impact of common equivalent shares outstanding is not included in the computation of diluted net loss per share as the impact of the shares would be antidilutive due to the net loss incurred for the period. Nonvested restricted stock awards (referred to as participating securities) are excluded from the dilutive impact of common equivalent shares outstanding in accordance with authoritative guidance under the two-class method since the nonvested restricted stockholders are entitled to participate in dividends declared on common stock as if the shares were fully vested and hence are deemed to be participating securities. Under the two-class method, distributed and undistributed earnings attributable to nonvested restricted stockholders are excluded from net earnings (loss) attributable to common stockholders for purposes of calculating basic and diluted earnings (loss) per common share. However, net losses are not allocated to nonvested restricted stockholders because they are not contractually obligated to share in the losses of the Company.

In addition, the Company has granted certain nonvested stock units that are subject to certain performance-based or market-based vesting conditions as well as continued service requirements through the respective vesting periods. These nonvested stock units are included in the computation of diluted net earnings per common share attributable to common stockholders only to the extent that the underlying performance-based or market-based vesting conditions are satisfied as of the end of the reporting period, or would be considered satisfied if the end



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of the reporting period were the end of the related contingency period, and the results would be dilutive under the treasury stock method.

The computation of basic and diluted net earnings (loss) per common share attributable to common stockholders is as follows (in thousands, except per share data):

|   | Three Months Ended |                 | Six Months Ended |                 |
|---|--------------------|-----------------|------------------|-----------------|
|   | Aug 4,<br>2018     | Jul 29,<br>2017 | Aug 4,<br>2018   | Jul 29,<br>2017 |
| Net earnings (loss) attributable to Guess?, Inc.                          | \$ 25,530          | \$ 15,219       | \$4,309          | \$(6,074)       |
| Less net earnings attributable to nonvested restricted stockholders       | 268                | 196             | 390              | 395             |
| Net earnings (loss) attributable to common stockholders                   | \$ 25,262          | \$ 15,023       | \$ 3,919         | \$(6,469)       |
| Weighted average common shares used in basic computations                 | 80,110             | 82,396          | 80,006           | 82,703          |
| Effect of dilutive securities:  |                    |                 |                  |                 |
| Stock options and restricted stock units (1)                              | 1,440              | 367             | 1,242            | —               |
| Weighted average common shares used in diluted computations               | 81,550             | 82,763          | 81,248           | 82,703          |
| Net earnings (loss) per common share attributable to common stockholders: |                    |                 |                  |                 |
| Basic   | \$ 0.32            | \$ 0.18         | \$0.05           | \$(0.08 )       |
| Diluted   | \$ 0.31            | \$ 0.18         | \$0.05           | \$(0.08 )       |

For the six months ended July 29, 2017, there were 192,438 of potentially dilutive shares that were not included in (1) the computation of diluted weighted average common shares and common equivalent shares outstanding because their effect would have been antidilutive given the Company's net loss.

For the three months ended August 4, 2018 and July 29, 2017, equity awards granted for 1,385,422 and 4,522,618, respectively, of the Company's common shares and for the six months ended August 4, 2018 and July 29, 2017, equity awards granted for 2,116,751 and 4,310,197, respectively, of the Company's common shares were outstanding but were excluded from the computation of diluted weighted average common shares and common equivalent shares outstanding because the assumed proceeds, as calculated under the treasury stock method, resulted in these awards being antidilutive. For three and six months ended August 4, 2018, the Company also excluded 1,361,550 nonvested stock units which are subject to the achievement of performance-based vesting conditions from the computation of diluted weighted average common shares and common equivalent shares outstanding because these conditions were not achieved as of August 4, 2018. For the three and six months ended July 29, 2017, the Company excluded 1,140,080 nonvested stock units which were subject to the achievement of performance-based vesting conditions from the computation of diluted weighted average common shares and common equivalent shares outstanding because these conditions were not achieved as of July 29, 2017.

#### Share Repurchase Program

On June 26, 2012, the Company's Board of Directors authorized a program to repurchase, from time-to-time and as market and business conditions warrant, up to \$500 million of the Company's common stock. Repurchases under the program may be made on the open market or in privately negotiated transactions, pursuant to Rule 10b5-1 trading plans or other available means. There is no minimum or maximum number of shares to be repurchased under the program, which may be discontinued at any time, without prior notice. During the six months ended August 4, 2018, the Company repurchased 1,118,808 shares under the program at an aggregate cost of \$17.6 million. The shares were repurchased during the three months ended May 5, 2018. During the six months ended August 4, 2018, the Company also paid an additional \$6.0 million for shares that were repurchased during the fourth quarter of fiscal 2018 but were settled during the first quarter of fiscal 2019. During the six months ended July 29, 2017, the Company repurchased 1,485,195 shares under the program at an aggregate cost of \$17.8 million. The shares were repurchased during the three months ended April 29, 2017. As of August 4, 2018, the Company had remaining authority under the program to purchase \$374.6 million of its common stock.



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## (4) Stockholders' Equity and Redeemable Noncontrolling Interests

A reconciliation of common stock outstanding, treasury stock and the total carrying amount of total stockholders' equity, Guess?, Inc. stockholders' equity and stockholders' equity attributable to nonredeemable and redeemable noncontrolling interests for the fiscal year ended February 3, 2018 and six months ended August 4, 2018 is as follows (in thousands, except share data):

|  | Shares       |                | Stockholders' Equity              |  |           | Redeemable Noncontrolling Interests |
|--|--------------|----------------|-----------------------------------|--|-----------|-------------------------------------|
|  | Common Stock | Treasury Stock | Guess?, Inc. Stockholders' Equity | Nonredeemable Noncontrolling Interests | Total     |                                     |
| Balance at January 28, 2017  | 84,069,492   | 56,440,482     | \$969,222                         | \$ 11,772                              | \$980,994 | \$ 4,452                            |
| Net earnings (loss)  | —            | —              | (7,894 )                          | 3,993                                  | (3,901 )  | —                                   |
| Foreign currency translation adjustment  | —            | —              | 91,178                            | 2,238                                  | 93,416    | 187                                 |
| Loss on derivative financial instruments designated as cash flow hedges, net of income tax of \$2,738  | —            | —              | (19,994 )                         | —                                      | (19,994 ) | —                                   |
| Actuarial valuation loss and related amortization, prior service credit amortization and foreign currency and other adjustments on defined benefit plans, net of income tax of \$435 | —            | —              | (1,647 )                          | —                                      | (1,647 )  | —                                   |
| Issuance of common stock under stock compensation plans, net of tax effect   | 1,113,713    | —              | (1,257 )                          | —                                      | (1,257 )  | —                                   |
| Issuance of stock under Employee Stock Purchase Plan   | 54,300       | (54,300 )      | 566                               | —                                      | 566       | —                                   |
| Share-based compensation   | —            | —              | 18,852                            | —                                      | 18,852    | —                                   |
| Dividends  | —            | —              | (76,048 )                         | —                                      | (76,048 ) | —                                   |
| Share repurchases  | (3,866,387 ) | 3,866,387      | (56,159 )                         | —                                      | (56,159 ) | —                                   |
| Noncontrolling interest capital contribution   | —            | —              | —                                 | 11                                     | 11        | 951                                 |
| Noncontrolling interest capital distribution   | —            | —              | —                                 | (1,358 )                               | (1,358 )  | —                                   |
| Balance at February 3, 2018  | 81,371,118   | 60,252,569     | \$916,819                         | \$ 16,656                              | \$933,475 | \$ 5,590                            |
| Cumulative adjustment from adoption of new accounting guidance   | —            | —              | 5,829                             | —                                      | 5,829     | —                                   |
| Net earnings   | —            | —              | 4,309                             | 438                                    | 4,747     | —                                   |
| Foreign currency translation adjustment  | —            | —              | (47,712 )                         | 187                                    | (47,525 ) | (639 )                              |
| Gain on derivative financial instruments designated as cash flow hedges, net of income tax of (\$2,130)  | —            | —              | 14,227                            | —                                      | 14,227    | —                                   |
| Actuarial valuation and prior service credit amortization and foreign currency and other adjustments on defined benefit plans, net of income tax of (\$65)                           | —            | —              | 527                               | —                                      | 527       | —                                   |
| Issuance of common stock under stock compensation plans, net of tax effect   | 749,349      | —              | 4,169                             | —                                      | 4,169     | —                                   |
| Issuance of stock under Employee Stock Purchase Plan   | 28,543       | (28,543 )      | 465                               | —                                      | 465       | —                                   |
| Share-based compensation   | —            | —              | 7,989                             | —                                      | 7,989     | —                                   |

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|  |              |            |           |           |           |          |
|--|--------------|------------|-----------|-----------|-----------|----------|
| Dividends                                    | —            | —          | (37,166 ) | —         | (37,166 ) | —        |
| Share repurchases                            | (1,118,808 ) | 1,118,808  | (17,587 ) | —         | (17,587 ) | —        |
| Noncontrolling interest capital distribution | —            | —          | —         | (3,069 )  | (3,069 )  | —        |
| Balance at August 4, 2018                    | 81,030,202   | 61,342,834 | \$851,869 | \$ 14,212 | \$866,081 | \$ 4,951 |

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## Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (loss), net of related income taxes, for the three and six months ended August 4, 2018 and July 29, 2017 are as follows (in thousands):

|  | Three Months Ended Aug 4, 2018                   |   |                             |               |
|--|--|---|-----------------------------|---------------|
|  | Foreign<br>Currency<br>Translation<br>Adjustment | Derivative<br>Financial<br>Instruments<br>Designated<br>as Cash<br>Flow<br>Hedges | Defined<br>Benefit<br>Plans | Total         |
| Balance at May 5, 2018                                   | \$ (91,297 )                                     | \$ (6,285 )   | \$ (11,208 )                | \$ (108,790 ) |
| Gains (losses) arising during the period                 | (23,464 )  | 4,111   | (34 )                       | (19,387 )     |
| Reclassification to net earnings for losses realized     | —  | 2,032   | 125                         | 2,157         |
| Net other comprehensive income (loss)                    | (23,464 )  | 6,143   | 91                          | (17,230 )     |
| Balance at August 4, 2018                                | \$ (114,761 )                                    | \$ (142 )   | \$ (11,117 )                | \$ (126,020 ) |
|  | Six Months Ended Aug 4, 2018                     |   |                             |               |
|  | Foreign<br>Currency<br>Translation<br>Adjustment | Derivative<br>Financial<br>Instruments<br>Designated<br>as Cash<br>Flow<br>Hedges | Defined<br>Benefit<br>Plans | Total         |
| Balance at February 3, 2018                              | \$ (67,049 )                                     | \$ (14,369 )  | \$ (11,644 )                | \$ (93,062 )  |
| Gains (losses) arising during the period                 | (47,712 )  | 10,579  | 277                         | (36,856 )     |
| Reclassification to net earnings for losses realized     | —  | 3,648   | 250                         | 3,898         |
| Net other comprehensive income (loss)                    | (47,712 )  | 14,227  | 527                         | (32,958 )     |
| Balance at August 4, 2018                                | \$ (114,761 )                                    | \$ (142 )   | \$ (11,117 )                | \$ (126,020 ) |
|  | Three Months Ended Jul 29, 2017                  |   |                             |               |
|  | Foreign<br>Currency<br>Translation<br>Adjustment | Derivative<br>Financial<br>Instruments<br>Designated<br>as Cash<br>Flow<br>Hedges | Defined<br>Benefit<br>Plans | Total         |
| Balance at April 29, 2017                                | \$ (146,754 )                                    | \$ 4,948  | \$ (8,486 )                 | \$ (150,292 ) |
| Gains (losses) arising during the period                 | 43,079   | (13,093 )   | (82 )                       | 29,904        |
| Reclassification to net loss for (gains) losses realized | —  | (606 )  | 85                          | (521 )        |
| Net other comprehensive income (loss)                    | 43,079   | (13,699 )   | 3                           | 29,383        |
| Balance at July 29, 2017                                 | \$ (103,675 )                                    | \$ (8,751 )   | \$ (8,483 )                 | \$ (120,909 ) |
|  | Six Months Ended Jul 29, 2017                    |   |                             |               |
|  | Foreign<br>Currency<br>Translation<br>Adjustment | Derivative<br>Financial<br>Instruments<br>Designated<br>as Cash<br>Flow           | Defined<br>Benefit<br>Plans | Total         |

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|  |             | Hedges      |           |             |
|--|-------------|-------------|-----------|-------------|
| Balance at January 28, 2017                              | \$(158,227) | \$ 5,400    | \$(8,562) | \$(161,389) |
| Gains (losses) arising during the period                 | 54,552      | (12,969 )   | (95 )     | 41,488      |
| Reclassification to net loss for (gains) losses realized | —           | (1,182 )    | 174       | (1,008 )    |
| Net other comprehensive income (loss)                    | 54,552      | (14,151 )   | 79        | 40,480      |
| Balance at July 29, 2017                                 | \$(103,675) | \$( 8,751 ) | \$(8,483) | \$(120,909) |

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Details on reclassifications out of accumulated other comprehensive income (loss) to net earnings (loss) during the three and six months ended August 4, 2018 and July 29, 2017 are as follows (in thousands):

|  | Three Months Ended |              | Six Months Ended |              | Location of (Gain) Loss Reclassified from Accumulated OCI into Earnings (Loss) |
|--|--------------------|--------------|------------------|--------------|--|
|  | Aug 4, 2018        | Jul 29, 2017 | Aug 4, 2018      | Jul 29, 2017 |  |
| Derivative financial instruments designated as cash flow hedges: |                    |              |                  |              |  |
| Foreign exchange currency contracts                              | \$2,342            | \$(661)      | \$4,028          | \$(1,279)    | Cost of product sales  |
| Foreign exchange currency contracts                              | —                  | (14)         | 201              | (93)         | Other income (expense)   |
| Interest rate swap   | (31)               | 26           | (39)             | 62           | Interest expense   |
| Less income tax effect   | (279)              | 43           | (542)            | 128          | Income tax expense   |
|  | 2,032              | (606)        | 3,648            | (1,182)      |  |
| Defined benefit plans:   |                    |              |                  |              |  |
| Net actuarial loss amortization (1)                              | 151                | 111          | 303              | 228          | Other income (expense)   |
| Prior service credit amortization (1)                            | (7)                | (6)          | (14)             | (13)         | Other income (expense)   |
| Less income tax effect   | (19)               | (20)         | (39)             | (41)         | Income tax expense   |
|  | 125                | 85           | 250              | 174          |  |
| Total reclassifications during the period                        | \$2,157            | \$(521)      | \$3,898          | \$(1,008)    |  |

(1) These accumulated other comprehensive income (loss) components are included in the computation of net periodic defined benefit pension cost. During the first quarter of fiscal 2019, the Company adopted new authoritative guidance which requires that the non-service components of net periodic defined benefit pension cost be presented outside of earnings (loss) from operations. The Company adopted this guidance on a retrospective basis and, as a result, reclassified these components from SG&A expenses to other income (expense) for the three and six months ended July 29, 2017. Refer to Note 13 for further information.

Redeemable Noncontrolling Interests

The Company is party to a put arrangement with respect to the common securities that represent the remaining noncontrolling interest for its majority-owned subsidiary, Guess Brasil Comércio e Distribuição S.A. (“Guess Brazil”), which was established through a majority-owned joint venture during fiscal 2014. The put arrangement for Guess Brazil, representing 40% of the total outstanding equity interest of that subsidiary, may be exercised at the discretion of the noncontrolling interest holder by providing written notice to the Company beginning in the sixth year of the agreement, or sooner in certain limited circumstances, and every third anniversary from the end of the sixth year thereafter subject to certain time restrictions. The redemption value of the Guess Brazil put arrangement is based on a multiple of Guess Brazil’s earnings before interest, taxes, depreciation and amortization subject to certain adjustments and is classified as a redeemable noncontrolling interest outside of permanent equity in the Company’s condensed consolidated balance sheet. The carrying value of the redeemable noncontrolling interest related to Guess Brazil was \$1.4 million and \$1.6 million as of August 4, 2018 and February 3, 2018, respectively.

The Company is also party to a put arrangement with respect to the common securities that represent the remaining noncontrolling interest for its majority-owned subsidiary, Guess? CIS, LLC (“Guess CIS”), which was established through a majority-owned joint venture during fiscal 2016. The put arrangement for Guess CIS, representing 30% of the total outstanding equity interest of that subsidiary, may be exercised at the discretion of the noncontrolling interest holder by providing written notice to the Company during the period beginning after the fifth anniversary of the agreement through December 31, 2025, or sooner in certain limited circumstances. The redemption value of the Guess CIS put arrangement is based on a multiple of Guess CIS’s earnings before interest, taxes, depreciation and

amortization subject to certain adjustments and is classified as a redeemable noncontrolling interest outside of permanent equity in the Company's condensed consolidated balance sheet. During fiscal 2018, the Company and the noncontrolling interest holder made additional capital contribution totaling \$3.2 million, of which \$2.2 million was paid by the Company and the remaining amount was paid by the noncontrolling interest holder to retain the same pro-rata interest in Guess CIS. The carrying value of the

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redeemable noncontrolling interest related to Guess CIS was \$3.6 million and \$4.0 million as of August 4, 2018 and February 3, 2018, respectively.

**(5) Accounts Receivable**

Accounts receivable is summarized as follows (in thousands):

|                     | Aug 4,<br>2018 | Feb 3,<br>2018 |
|---------------------|----------------|----------------|
| Trade               | \$280,739      | \$290,478      |
| Royalty             | 6,859          | 5,504          |
| Other               | 7,360          | 13,233         |
|                     | 294,958        | 309,215        |
| Less allowances (1) | 11,583         | 49,219         |
|                     | \$283,375      | \$259,996      |

As of February 3, 2018, the accounts receivable allowance included allowances for doubtful accounts, wholesale sales returns and wholesale markdowns. During the first quarter of fiscal 2019, the Company adopted a new revenue recognition standard on a modified retrospective basis which changed the presentation of allowances for wholesale sales returns and wholesale markdowns to be classified within accrued expenses rather than as a reduction to accounts receivable. Accordingly, the Company has included allowances of \$27.0 million and \$10.8 million related to wholesale sales returns and wholesale markdowns, respectively, in accrued expenses as of August 4, 2018. As of August 4, 2018, the accounts receivable allowance was only related to allowances for doubtful accounts. Refer to Notes 1 and 2 for further information regarding the impact from the adoption of the new revenue recognition standard on the Company's condensed consolidated financial statements and related disclosures during the second quarter of fiscal 2019.

Accounts receivable consists of trade receivables relating primarily to the Company's wholesale business in Europe and, to a lesser extent, to its wholesale businesses in the Americas and Asia, royalty receivables relating to its licensing operations, credit card and retail concession receivables related to its retail businesses and certain other receivables. Other receivables generally relate to amounts due to the Company that result from activities that are not related to the direct sale of the Company's products or collection of royalties.

**(6) Inventories**

Inventories consist of the following (in thousands):

|                    | Aug 4,<br>2018 | Feb 3,<br>2018 |
|--------------------|----------------|----------------|
| Raw materials      | \$697          | \$604          |
| Work in progress   | 21             | 16             |
| Finished goods (1) | 463,813        | 427,684        |
|                    | \$464,531      | \$428,304      |

During the first quarter of fiscal 2019, the Company adopted a new revenue recognition standard on a modified retrospective basis which changed the presentation of the estimated cost associated with the allowance for sales returns to be included within other current assets rather than included in inventories. Accordingly, the Company (1) has included \$11.6 million related to the estimated cost associated with the allowance for sales returns in other current assets as of August 4, 2018. Refer to Notes 1 and 2 for further information regarding the impact from the adoption of the new revenue recognition standard on the Company's condensed consolidated financial statements and related disclosures during the second quarter of fiscal 2019.

The above balances include an allowance to write down inventories to the lower of cost or net realizable value of \$27.5 million and \$29.9 million as of August 4, 2018 and February 3, 2018, respectively.

**(7) Income Taxes**

Income tax expense for the interim periods was computed using the tax rate estimated to be applicable for the full fiscal year, adjusted for discrete items. The Company's effective income tax rate was 24.0% for the six months ended

August 4, 2018, compared to negative 1,706.1% for the six months ended July 29, 2017. The

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improvement in the effective income tax rate during the six months ended August 4, 2018 was due primarily to lower losses in jurisdictions which the Company has valuation allowances and, to a lesser extent, the reversal of a valuation allowance on certain deferred taxes and the favorable impact from the enactment of the 2017 Tax Cuts and Jobs Act in the U.S. (referred to herein as the “Tax Reform”).

In December 2017, the U.S. government enacted the Tax Reform, which significantly changed the U.S. corporate income tax laws, including lowering the U.S. federal corporate income tax rate from 35% to 21% and requiring a one-time mandatory transition tax on accumulated foreign earnings. The Tax Reform also establishes new tax laws that are effective for calendar 2018, including but not limited to (i) a new provision designed to tax global intangible low-taxed income (“GILTI”), (ii) a general elimination of U.S. federal income taxes on dividends from foreign subsidiaries, (iii) a limitation on deductible interest expense and (iv) limitations on the deductibility of certain executive compensation. The income tax payable related to the transition tax is due over an eight-year period beginning in calendar 2018. The Company included \$0.4 million and \$17.7 million related to the transition tax in accrued expenses and other long-term liabilities in its condensed consolidated balance sheets as of August 4, 2018, respectively. The Company included \$1.9 million and \$17.7 million related to the transition tax in accrued expenses and other long-term liabilities in its condensed consolidated balance sheets as of February 3, 2018, respectively. The Securities and Exchange Commission (“SEC”) issued authoritative guidance which addresses accounting for the impact of the Tax Reform. This guidance provides a measurement period, which should not extend beyond one year from the enactment date, during which the Company may finalize the accounting for the impacts of the Tax Reform, and allows for the Company to record provisional estimates of such amounts. Based on the Company’s interpretation of the Tax Reform, reasonable estimates were made to record provisional adjustments during the fourth quarter of fiscal 2018. These estimates may change, and the Company will continue to refine such amounts within the measurement period allowed. The Company continues to analyze the provisions of the Tax Reform, including but not limited to, the creation of a new minimum tax called the base erosion anti-abuse tax; a new provision that taxes U.S. allocated expenses (e.g. interest and general administrative expenses) as well as certain GILTI from foreign operations; a general elimination of U.S. federal income taxes on dividends from foreign subsidiaries; a new limitation on deductible interest expense; and limitations on the deductibility of certain employee compensation. Under GAAP, companies are allowed to make an accounting policy election to either treat taxes resulting from GILTI as a current-period expense when they are incurred or factor such amounts into the measurement of deferred taxes. The Company has not completed its analysis of the effects of the GILTI provisions and will further consider the accounting policy election within the measurement period allowed.

From time-to-time, the Company is subject to routine income tax audits on various tax matters around the world in the ordinary course of business. As of August 4, 2018, several income tax audits were underway for various periods in multiple jurisdictions. The Company accrues an amount for its estimate of additional income tax liability which the Company, more likely than not, will incur as a result of the ultimate resolution of income tax audits (“uncertain tax positions”). The Company reviews and updates the estimates used in the accrual for uncertain tax positions as more definitive information becomes available from taxing authorities, upon completion of tax audits, upon expiration of statutes of limitation, or upon occurrence of other events.

The Company had aggregate accruals for uncertain tax positions, including penalties and interest, of \$18.9 million and \$19.0 million as of August 4, 2018 and February 3, 2018, respectively.

**(8) Segment Information**

The Company’s businesses are grouped into five reportable segments for management and internal financial reporting purposes: Americas Retail, Americas Wholesale, Europe, Asia and Licensing. The Company’s Americas Retail, Americas Wholesale, Europe and Licensing reportable segments are the same as their respective operating segments. Certain components of the Company’s Asia operating segment are separate operating segments based on region, which have been aggregated into the Asia reportable segment for disclosure purposes. Management evaluates segment performance based primarily on revenues and earnings (loss) from operations before corporate performance-based compensation costs, net gains (losses) from lease terminations, asset impairment charges and





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restructuring charges, if any. The Company believes this segment reporting reflects how its business segments are managed and how each segment's performance is evaluated by the Company's chief operating decision maker to assess performance and make resource allocation decisions. The Americas Retail segment includes the Company's retail and e-commerce operations in North and Central America and the Company's retail operations in South America. The Americas Wholesale segment includes the Company's wholesale operations in the Americas. The Europe segment includes the Company's retail, e-commerce and wholesale operations in Europe and the Middle East. The Asia segment includes the Company's retail, e-commerce and wholesale operations in Asia and the Pacific. The Licensing segment includes the worldwide licensing operations of the Company. The business segment operating results exclude corporate overhead costs, which consist of shared costs of the organization, net gains (losses) on lease terminations, asset impairment charges and restructuring charges. Corporate overhead costs are presented separately and generally include, among other things, the following unallocated corporate costs: accounting and finance, executive compensation, corporate performance-based compensation, facilities, global advertising and marketing, human resources, information technology and legal.

Net revenue and earnings (loss) from operations are summarized as follows for the three and six months ended August 4, 2018 and July 29, 2017 (in thousands):

|  | Three Months Ended |                 | Six Months Ended |              |
|--|--------------------|-----------------|------------------|--------------|
|  | Aug 4,<br>2018     | Jul 29,<br>2017 | Aug 4, 2018      | Jul 29, 2017 |
| Net revenue:                                       |                    |                 |                  |              |
| Americas Retail                                    | \$ 197,125         | \$ 201,188      | \$ 368,465       | \$ 374,882   |
| Americas Wholesale                                 | 34,253             | 32,658          | 74,932           | 68,515       |
| Europe   | 311,998            | 255,215         | 517,433          | 420,603      |
| Asia   | 82,786             | 62,733          | 166,837          | 126,114      |
| Licensing (1) (2)                                  | 19,709             | 16,498          | 39,493           | 32,523       |
| Total net revenue (1) (2)                          | \$ 645,871         | \$ 568,292      | \$ 1,167,160     | \$ 1,022,637 |
| Earnings (loss) from operations:                   |                    |                 |                  |              |
| Americas Retail (2) (3) (4)                        | \$ 5,582           | \$ (3,555 )     | \$ (98 )         | \$ (25,136 ) |
| Americas Wholesale (2) (3) (4)                     | 5,325              | 5,238           | 11,351           | 12,221       |
| Europe (3) (4) (5)                                 | 30,531             | 30,058          | 10,198           | 29,052       |
| Asia (3) (4)                                       | 1,634              | 2,441           | 5,699            | 2,780        |
| Licensing (2) (3) (4)                              | 17,437             | 14,389          | 34,923           | 27,850       |
| Total segment earnings from operations (2) (3) (5) | 60,509             | 48,571          | 62,073           | 46,767       |
| Corporate overhead (2) (3) (5)                     | (25,647 )          | (23,551 )       | (51,492 )        | (43,960 )    |
| Net gains on lease terminations (3) (6)            | —                  | —               | 152              | —            |
| Asset impairment charges (3) (7)                   | (2,981 )           | (1,233 )        | (3,740 )         | (3,995 )     |
| Total earnings (loss) from operations (2) (5)      | \$ 31,881          | \$ 23,787       | \$ 6,993         | \$ (1,188 )  |

During the fourth quarter of fiscal 2018, the Company reclassified net royalties received on the Company's inventory purchases of licensed product from net revenue to cost of product sales to reflect its treatment as a (1) reduction of the cost of such licensed product. Accordingly, net revenue for the three and six months ended July 29, 2017 has been adjusted to conform to the current period presentation. This reclassification had no impact on previously reported earnings (loss) from operations.

(2) During the first quarter of fiscal 2019, the Company adopted a comprehensive new revenue recognition standard using a modified retrospective method that does not restate prior periods to be comparable to the current period presentation. The adoption of this guidance primarily impacted the presentation of advertising contributions received from the Company's licensees and the related advertising expenditures incurred by the Company. The adoption of this guidance resulted in an increase in net royalty revenue within the Company's Licensing segment of \$2.1 million, as well as an increase in SG&A expenses in our Americas Retail, Americas Wholesale and Licensing segments as well as corporate overhead of \$0.5 million, \$0.2 million, \$0.2 million and \$0.5 million, respectively,

during the three months ended August 4, 2018 compared to the same prior-year period. The net favorable impact on earnings from operations was approximately \$0.6 million during the three months ended August 4, 2018 compared to the same prior-year period. During the six months ended August 4, 2018, the adoption of this guidance resulted in an increase in net royalty revenue within the Company's Licensing segment of \$4.4 million, as well as an increase in SG&A expenses in our Americas Retail, Americas Wholesale and Licensing segments as well as corporate overhead of \$2.3 million, \$0.9 million, \$0.4 million and \$1.1 million,

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respectively, during the six months ended August 4, 2018 compared to the same prior-year period. The net unfavorable impact on earnings from operations was approximately \$0.4 million during the six months ended August 4, 2018 compared to the same prior-year period. Refer to Note 1 for more information regarding the impact from the adoption of this new standard.

During the third quarter of fiscal 2018, segment results were adjusted to exclude corporate performance-based compensation costs, net gains (losses) on lease terminations and asset impairment charges due to the fact that these (3) items are no longer included in the segment results provided to the Company's chief operating decision maker in order to allocate resources and assess performance. Accordingly, segment results have been adjusted for the three and six months ended July 29, 2017 to conform to the current period presentation.

During the first quarter of fiscal 2019, the Company changed the segment accountability for funds received from licensees on the Company's purchases of its licensed products. These amounts were treated as a reduction of cost of (4) product sales within the Licensing segment but now are considered in the results of the segments that control the respective purchases for purposes of segment performance evaluation. Accordingly, segment results for the three and six months ended July 29, 2017 have been adjusted to conform to the current period presentation.

During the first quarter of fiscal 2019, the Company adopted new authoritative guidance which requires that the (5) non-service components of net periodic defined benefit pension cost be presented outside of earnings (loss) from operations. Accordingly, earnings (loss) from operations and segment results for the three and six months ended July 29, 2017 have been adjusted to conform to the current period presentation.

During the six months ended August 4, 2018, the Company recorded net gains on lease terminations related (6) primarily to the early termination of certain lease agreements in North America. The net gains on lease terminations were recorded during the three months ended May 5, 2018. Refer to Note 1 for more information regarding the net gains on lease terminations.

During each of the periods presented, the Company recognized asset impairment charges for certain retail locations (7) resulting from under-performance and expected store closures. Refer to Note 14 for more information regarding these asset impairment charges.

The table below presents information regarding geographic areas in which the Company operated. Net revenue is classified primarily based on the country where the Company's customer is located (in thousands):

|                         | Three Months Ended |                 | Six Months Ended |                 |
|-------------------------|--------------------|-----------------|------------------|-----------------|
|                         | Aug 4,<br>2018     | Jul 29,<br>2017 | Aug 4,<br>2018   | Jul 29,<br>2017 |
| Net revenue:            |                    |                 |                  |                 |
| U.S.                    | \$176,064          | \$174,991       | \$338,434        | \$337,171       |
| Italy                   | 89,380             | 81,196          | 148,286          | 128,394         |
| Canada                  | 45,822             | 49,130          | 86,335           | 89,524          |
| South Korea             | 35,996             | 34,283          | 74,083           | 72,838          |
| Other foreign countries | 298,609            | 228,692         | 520,022          | 394,710         |
| Total net revenue       | \$645,871          | \$568,292       | \$1,167,160      | \$1,022,637     |

Due to the seasonal nature of the Company's business segments, the above net revenue and operating results are not necessarily indicative of the results that may be expected for the full fiscal year.

(9) Borrowings and Capital Lease Obligations

Borrowings and capital lease obligations are summarized as follows (in thousands):

|  | Aug 4,<br>2018 | Feb 3,<br>2018 |
|--|----------------|----------------|
| Mortgage debt, maturing monthly through January 2026 | \$19,982       | \$20,323       |
| Capital lease obligations                            | 17,671         | 18,589         |
| Other  | 2,796          | 3,129          |
|  | 40,449         | 42,041         |
| Less current installments                            | 3,504          | 2,845          |
| Long-term debt and capital lease obligations         | \$36,945       | \$39,196       |



Table of Contents**Mortgage Debt**

On February 16, 2016, the Company entered into a ten-year \$21.5 million real estate secured loan (the “Mortgage Debt”). The Mortgage Debt is secured by the Company’s U.S. distribution center based in Louisville, Kentucky and provides for monthly principal and interest payments based on a 25-year amortization schedule, with the remaining principal balance and any accrued and unpaid interest due at maturity. Outstanding principal balances under the Mortgage Debt bear interest at the one-month LIBOR rate plus 1.5%. As of August 4, 2018, outstanding borrowings under the Mortgage Debt, net of debt issuance costs of \$0.1 million, were \$20.0 million. At February 3, 2018, outstanding borrowings under the Mortgage Debt, net of debt issuance costs of \$0.1 million, were \$20.3 million. The Mortgage Debt requires the Company to comply with a fixed charge coverage ratio on a trailing four-quarter basis if consolidated cash, cash equivalents and short term investment balances fall below certain levels. In addition, the Mortgage Debt contains customary covenants, including covenants that limit or restrict the Company’s ability to incur liens on the mortgaged property and enter into certain contractual obligations. Upon the occurrence of an event of default under the Mortgage Debt, the lender may terminate the Mortgage Debt and declare all amounts outstanding to be immediately due and payable. The Mortgage Debt specifies a number of events of default (some of which are subject to applicable grace or cure periods), including, among other things, non-payment defaults, covenant defaults, cross-defaults to other material indebtedness, bankruptcy and insolvency defaults and material judgment defaults. On February 16, 2016, the Company also entered into a separate interest rate swap agreement, designated as a cash flow hedge, that resulted in a swap fixed rate of approximately 3.06%. This interest rate swap agreement matures in January 2026 and converts the nature of the Mortgage Debt from LIBOR floating-rate debt to fixed-rate debt. The fair value of the interest rate swap asset for each of the periods ended August 4, 2018 and February 3, 2018 was approximately \$1.5 million.

**Capital Lease Obligations**

During fiscal 2018, the Company began the relocation of its European distribution center to the Netherlands. As a result, the Company entered into a capital lease of \$17.0 million for equipment used in the new facility. The capital lease primarily provides for monthly minimum lease payments through May 2027 with an effective interest rate of approximately 6%. As of August 4, 2018 and February 3, 2018, the capital lease obligation was \$15.4 million and \$17.3 million, respectively.

The Company also has smaller capital leases related primarily to computer hardware and software. As of August 4, 2018 and February 3, 2018, these capital lease obligations totaled \$2.3 million and \$1.3 million, respectively.

**Credit Facilities**

On June 23, 2015, the Company entered into a five-year senior secured asset-based revolving credit facility with Bank of America, N.A. and the other lenders party thereto (the “Credit Facility”). The Credit Facility provides for a borrowing capacity in an amount up to \$150 million, including a Canadian sub-facility up to \$50 million, subject to a borrowing base. Based on applicable accounts receivable, inventory, eligible cash balances and relevant covenant restrictions as of August 4, 2018, the Company could have borrowed up to \$104 million under the Credit Facility. The Credit Facility has an option to expand the borrowing capacity by up to \$150 million subject to certain terms and conditions, including the willingness of existing or new lenders to assume such increased amount. The Credit Facility is available for direct borrowings and the issuance of letters of credit, subject to certain letters of credit sublimits, and may be used for working capital and other general corporate purposes.

All obligations under the Credit Facility are unconditionally guaranteed by the Company and the Company’s existing and future domestic and Canadian subsidiaries, subject to certain exceptions, and are secured by a first priority lien on substantially all of the assets of the Company and such domestic and Canadian subsidiaries, as applicable.

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Direct borrowings under the Credit Facility made by the Company and its domestic subsidiaries shall bear interest at the U.S. base rate plus an applicable margin (varying from 0.25% to 0.75%) or at LIBOR plus an applicable margin (varying from 1.25% to 1.75%). The U.S. base rate is based on the greater of (i) the U.S. prime rate, (ii) the federal funds rate, plus 0.5%, and (iii) LIBOR for a 30 day interest period, plus 1.0%. Direct borrowings under the Credit Facility made by the Company's Canadian subsidiaries shall bear interest at the Canadian prime rate plus an applicable margin (varying from 0.25% to 0.75%) or at the Canadian BA rate plus an applicable margin (varying from 1.25% to 1.75%). The Canadian prime rate is based on the greater of (i) the Canadian prime rate, (ii) the Bank of Canada overnight rate, plus 0.5%, and (iii) the Canadian BA rate for a one month interest period, plus 1.0%. The applicable margins are calculated quarterly and vary based on the average daily availability of the aggregate borrowing base. The Company is also obligated to pay certain commitment, letter of credit and other fees customary for a credit facility of this size and type. As of August 4, 2018, the Company had \$1.6 million in outstanding standby letters of credit, no outstanding documentary letters of credit and no outstanding borrowings under the Credit Facility.

The Credit Facility requires the Company to comply with a fixed charge coverage ratio on a trailing four-quarter basis if a default or an event of default occurs under the Credit Facility or generally if borrowings exceed 80% of the borrowing base. In addition, the Credit Facility contains customary covenants, including covenants that limit or restrict the Company and certain of its subsidiaries' ability to: incur liens, incur indebtedness, make investments, dispose of assets, make certain restricted payments, merge or consolidate and enter into certain transactions with affiliates. Upon the occurrence of an event of default under the Credit Facility, the lenders may cease making loans, terminate the Credit Facility and declare all amounts outstanding to be immediately due and payable. The Credit Facility specifies a number of events of default (some of which are subject to applicable grace or cure periods), including, among other things, non-payment defaults, covenant defaults, cross-defaults to other material indebtedness, bankruptcy and insolvency defaults and material judgment defaults. The Credit Facility allows for both secured and unsecured borrowings outside of the Credit Facility up to specified amounts.

The Company, through its European subsidiaries, maintains short-term uncommitted borrowing agreements, primarily for working capital purposes, with various banks in Europe. The majority of the borrowings under these agreements are secured by specific accounts receivable balances. Based on the applicable accounts receivable balances as of August 4, 2018, the Company could have borrowed or entered into documentary letters of credit totaling up to \$83.7 million under these agreements. As of August 4, 2018, the Company had no outstanding borrowings or outstanding documentary letters of credit under these agreements. The agreements are denominated primarily in euros and provide for annual interest rates ranging from 0.5% to 4.6%. The maturities of any short-term borrowings under these arrangements are generally linked to the credit terms of the underlying accounts receivable that secure the borrowings. With the exception of one facility for up to \$40.5 million that has a minimum net equity requirement, there are no other financial ratio covenants.

**Other**

From time-to-time, the Company will obtain other financing in foreign countries for working capital to finance its local operations.

**(10) Share-Based Compensation**

The following table summarizes the share-based compensation expense recognized under all of the Company's stock plans during the three and six months ended August 4, 2018 and July 29, 2017 (in thousands):

|  | Three Months Ended |              | Six Months Ended |              |
|--|--------------------|--------------|------------------|--------------|
|  | Aug 4, 2018        | Jul 29, 2017 | Aug 4, 2018      | Jul 29, 2017 |
| Stock options                          | \$ 672             | \$ 581       | \$ 1,367         | \$ 1,190     |
| Stock awards/units                     | 3,292              | 3,563        | 6,462            | 6,881        |
| Employee Stock Purchase Plan           | 67                 | 43           | 160              | 79           |
| Total share-based compensation expense | \$ 4,031           | \$ 4,187     | \$ 7,989         | \$ 8,150     |

Unrecognized compensation cost related to nonvested stock options and nonvested stock awards/units totaled approximately \$4.8 million and \$44.5 million, respectively, as of August 4, 2018. This cost is expected to be



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recognized over a weighted average period of 1.7 years. The weighted average grant date fair value of stock options granted was \$5.89 and \$1.57 during the six months ended August 4, 2018 and July 29, 2017, respectively.

**Grants**

On June 25, 2018, the Company granted select key management 619,578 nonvested stock units which are subject to certain performance-based vesting or market-based vesting conditions. On April 28, 2017, the Company granted select key management 1,056,042 nonvested stock units which are subject to certain performance-based vesting or market-based vesting conditions.

**Annual Grants**

On March 30, 2018, the Company made an annual grant of 431,371 stock options and 490,528 nonvested stock awards/units to its employees. On March 29, 2017, the Company made an annual grant of 1,283,175 stock options and 707,675 nonvested stock awards/units to its employees.

**Performance-Based Awards**

The Company has granted certain nonvested stock units subject to performance-based vesting conditions to select executive officers. Each award of nonvested stock units generally has an initial vesting period from the date of the grant through either (i) the end of the first fiscal year or (ii) the first anniversary of the date of grant, followed by annual vesting periods which may range from two-to-three years.

The Company has also granted a target number of nonvested stock units to select key management, including certain executive officers. The number of shares that may ultimately vest with respect to each award may range from 0% up to 200% of the target number of shares, subject to the achievement of certain performance-based vesting conditions. Any shares that are ultimately issued are scheduled to vest at the end of the third fiscal year following the grant date. The following table summarizes the activity for nonvested performance-based units during the six months ended August 4, 2018:

|                               | Number of<br>Units | Grant<br>Date<br>Fair<br>Value | Weighted<br>Average |
|-------------------------------|--------------------|--------------------------------|---------------------|
| Nonvested at February 3, 2018 | 1,300,921          |                                | \$ 14.01            |
| Granted                       | 489,646            |                                | 21.83               |
| Vested                        | (141,625 )         |                                | 15.07               |
| Forfeited                     | (27,441 )          |                                | 11.16               |
| Nonvested at August 4, 2018   | 1,621,501          |                                | \$ 16.33            |

**Market-Based Awards**

The Company has granted certain nonvested stock units subject to market-based vesting conditions to select executive officers. The number of shares that may ultimately vest will equal 0% to 150% of the target number of shares, subject to the performance of the Company's total stockholder return ("TSR") relative to the TSR of a select group of peer companies over a three-year period. Vesting is also subject to continued service requirements through the vesting date.



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The following table summarizes the activity for nonvested market-based units during the six months ended August 4, 2018:

|                               | Number<br>of<br>Units | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|-------------------------------|-----------------------|---|
| Nonvested at February 3, 2018 | 388,477               | \$ 12.28  |
| Granted                       | 129,932               | 20.28   |
| Vested                        | —                     | —   |
| Forfeited                     | —                     | —   |
| Nonvested at August 4, 2018   | 518,409               | \$ 14.28  |

(11) Related Party Transactions

The Company and its subsidiaries periodically enter into transactions with other entities or individuals that are considered related parties, including certain transactions with entities affiliated with trusts for the respective benefit of Paul Marciano, who is an executive and member of the Board of the Company, and Maurice Marciano, Chairman of the Board, and certain of their children (the “Marciano Trusts”).

Leases

The Company leases warehouse and administrative facilities, including the Company’s corporate headquarters in Los Angeles, California, from partnerships affiliated with the Marciano Trusts and certain of their affiliates. There were four of these leases in effect as of August 4, 2018 with expiration or option exercise dates ranging from calendar years 2018 to 2020.

Aggregate rent, common area maintenance charges and property tax expense recorded under these four related party leases were approximately \$2.5 million for each of the six months ended August 4, 2018 and July 29, 2017. The Company believes that the terms of the related party leases have not been significantly affected by the fact that the Company and the lessors are related.

Aircraft Arrangements

The Company periodically charters aircraft owned by entities affiliated with the Marciano Trusts (the “Aircraft Entities”), through informal arrangements with the Aircraft Entities and independent third party management companies contracted by the Aircraft Entities to manage their aircraft. The total fees paid under these arrangements for the six months ended August 4, 2018 and July 29, 2017 were approximately \$0.8 million and \$0.4 million, respectively.

These related party disclosures should be read in conjunction with the disclosure concerning related party transactions in the Company’s Annual Report on Form 10-K for the year ended February 3, 2018.

(12) Commitments and ContingenciesLeases

The Company leases its showrooms, advertising, licensing, sales and merchandising offices, remote distribution and warehousing facilities and retail and factory outlet store locations under operating lease agreements expiring on various dates through October 2037. Some of these leases require the Company to make periodic payments for property taxes, utilities and common area operating expenses. Certain retail store leases provide for rents based upon the minimum annual rental amount and a percentage of annual sales volume, generally ranging from 4% to 20%, when specific sales volumes are exceeded. The Company’s retail concession leases also provide for rents primarily based upon a percentage of annual sales volume which average approximately 35% of annual sales volume. Some leases include lease incentives, rent abatements and fixed rent escalations, which are amortized and recorded over the initial lease term on a straight-line basis. The Company also leases some of its equipment under operating lease agreements expiring at various dates through June 2023.



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As discussed in further detail in Note 9, the Company leases equipment as well as computer hardware and software under capital lease obligations.

Investment Commitments

As of August 4, 2018, the Company had an unfunded commitment to invest €3.6 million (\$4.2 million) in a private equity fund. Refer to Note 14 for further information.

Legal Proceedings

The Company is involved in legal proceedings, arising both in the ordinary course of business and otherwise, including the proceedings described below as well as various other claims and other matters incidental to the Company's business. Unless otherwise stated, the resolution of any particular proceeding is not currently expected to have a material adverse impact on the Company's financial position or results of operations. Even if such an impact could be material, we may not be able to estimate the reasonably possible loss or range of loss until developments in the proceedings have provided sufficient information to support an assessment.

On May 6, 2009, Gucci America, Inc. filed a complaint in the U.S. District Court for the Southern District of New York against Guess?, Inc. and certain third party licensees for the Company asserting, among other things, trademark and trade dress law violations and unfair competition. The complaint sought injunctive relief, compensatory damages, including treble damages, and certain other relief. Complaints similar to those in the above action were subsequently filed by Gucci entities against the Company and certain of its subsidiaries in the Court of Milan, Italy, the Intermediate People's Court of Nanjing, China and the Court of Paris, France. The three-week bench trial in the U.S. matter concluded on April 19, 2012, with the court issuing a preliminary ruling on May 21, 2012 and a final ruling on July 19, 2012. Although the plaintiff was seeking compensation in the U.S. matter in the form of damages of \$26 million and an accounting of profits of \$99 million, the final ruling provided for monetary damages of \$2.3 million against the Company and \$2.3 million against certain of its licensees. The court also granted narrow injunctions in favor of the plaintiff for certain of the claimed infringements. On August 20, 2012, the appeal period expired without any party having filed an appeal, rendering the judgment final. On May 2, 2013, the Court of Milan ruled in favor of the Company in the Milan, Italy matter. In the ruling, the Court rejected all of the plaintiff's claims and ordered the cancellation of three of the plaintiff's Italian and four of the plaintiff's European Community trademark registrations. On June 10, 2013, the plaintiff appealed the Court's ruling in the Milan matter. On September 15, 2014, the Court of Appeal of Milan affirmed the majority of the lower Court's ruling in favor of the Company, but overturned the lower Court's finding with respect to an unfair competition claim. That portion of the matter moved to a damages phase based on the ruling. On October 16, 2015, the plaintiff appealed the remainder of the Court of Appeal of Milan's ruling in favor of the Company to the Italian Supreme Court of Cassation. In the China matter, the Intermediate People's Court of Nanjing, China issued a ruling on November 8, 2013 granting an injunction in favor of the plaintiff for certain of the claimed infringements on handbags and small leather goods and awarding the plaintiff statutory damages in the amount of approximately \$80,000. The Company strongly disagreed with the Court's decision and appealed the ruling. On August 31, 2016, the Court of Appeal for the China matter issued a decision in favor of the Company, rejecting all of the plaintiff's claims. In March 2017, the plaintiff petitioned the China Supreme Court for a retrial of the matter. On January 30, 2015, the Court of Paris ruled in favor of the Company in the France matter, rejecting all of the plaintiff's claims and partially canceling two of the plaintiff's community trademark registrations and one of the plaintiff's international trademark registrations. On February 17, 2015, the plaintiff appealed the Court of Paris' ruling. In April 2018, the parties entered into an agreement to settle all pending worldwide intellectual property litigation and trademark office matters between the parties and their subsidiaries, including the previously active litigation matters in Italy, China and France. As part of the settlement, the parties agreed on the use of various design elements by each party on a go-forward basis. The settlement did not have a significant impact on the Company's financial results, and the terms of the settlement are not expected to have a negative impact on the Company's business operations going forward.

The Company has received customs tax assessment notices from the Italian Customs Agency ("ICA") regarding its customs tax audit of one of the Company's European subsidiaries for the period from July 2010 through December 2012. Such assessments totaled €9.8 million (\$11.4 million), including potential penalties and



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interest. The Company strongly disagrees with the positions that the ICA has taken and therefore filed appeals with the Milan First Degree Tax Court (“MFDTC”). In May 2015, the MFDTC issued a judgment in favor of the Company in relation to the first set of appeals (covering the period through September 2010) and canceled the related assessments totaling €1.7 million (\$2.0 million). In November 2015, the ICA notified the Company of its intent to appeal this first MFDTC judgment. During fiscal 2017, the Appeals Court ruled in favor of the Company and rejected the appeal by the ICA on the first MFDTC judgment. The ICA has appealed the majority of these to the Italian Supreme Court. During fiscal 2017, the MFDTC also issued judgments in favor of the Company in relation to the second through seventh set of appeals (covering the period from October 2010 through December 2012) and canceled the related assessments totaling €8.1 million (\$9.4 million). Subsequently, the Italian Customs Agency has appealed the majority of these favorable MFDTC judgments, as well as certain of the Appeals Court judgments. In April 2018, a different judge within the Appeals Court ruled in favor of the ICA with respect to a portion of the outstanding appeals (covering the period from October through December 2010) totaling €1.2 million (\$1.4 million). The Company believes that this recent Appeals Court ruling is incorrect and inconsistent with the prior rulings on similar matters by both the MFDTC and other judges within the Appeals Court, and plans to appeal the decision. In July 2018, a different section of the Appeals Court ruled in favor of the Company and rejected the appeals by the ICA with respect to a portion of the outstanding appeals (covering the periods from January through June 2012 and August through December 2012) totaling €3.0 million (\$3.4 million). There can be no assurances the Company will be successful in the remaining appeals. It also continues to be possible that the Company will receive similar or even larger assessments for periods subsequent to December 2012 or other claims or charges related to the matter in the future. Although the Company believes that it has a strong position and will continue to vigorously defend this matter, it is unable to predict with certainty whether or not these efforts will ultimately be successful or whether the outcome will have a material impact on the Company’s financial position or results of operations.

On June 6, 2017, the European Commission notified the Company that it had initiated proceedings to investigate whether certain of the Company’s practices and agreements concerning the distribution of apparel and accessories within the European Union breach European Union competition rules related to cross-border transactions, internet sales limitations and resale price restrictions. The Company has cooperated and plans to continue to cooperate with the European Commission, including through responses to requests for information and through changes to certain business practices and agreements, as appropriate. Depending on the outcome of the proceedings, a broad range of remedies is potentially available to the European Commission, including imposing a fine and/or injunctive relief prohibiting or restricting certain business practices. However, the Company does not currently believe that any changes to its business practices or agreements made in connection with these proceedings will have a material impact on its ongoing business operations within the European Union. As of November 6, 2017, the Company and the European Commission agreed to begin a settlement discussion process to determine if the parties can mutually agree on an outcome of the proceedings. Those discussions are still ongoing. To the extent the Company and the European Commission are able to reach an agreement, such agreement could occur as early as during fiscal 2019, although any resolution may be delayed due to the inherent unpredictability of the proceedings. Although it is currently not possible to assess the impact any settlement or other conclusion may have on our consolidated financial statements because the process is still ongoing, it is possible that the result could have a material adverse effect on our financial statements in the applicable reporting period.

**(13) Defined Benefit Plans****Supplemental Executive Retirement Plan**

On August 23, 2005, the Board of Directors of the Company adopted a Supplemental Executive Retirement Plan (“SERP”) which became effective January 1, 2006. The SERP provides select employees who satisfy certain eligibility requirements with certain benefits upon retirement, termination of employment, death, disability or a change in control of the Company, in certain prescribed circumstances.

As a non-qualified pension plan, no dedicated funding of the SERP is required; however, the Company has made periodic payments into insurance policies held in a rabbi trust to fund the expected obligations arising under



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the non-qualified SERP. The amount of any future payments into the insurance policies, if any, may vary depending on investment performance of the trust. The cash surrender values of the insurance policies were \$64.3 million and \$64.5 million as of August 4, 2018 and February 3, 2018, respectively, and were included in other assets in the Company's condensed consolidated balance sheets. As a result of changes in the value of the insurance policy investments, the Company recorded unrealized gains of \$1.7 million and \$0.7 million in other income during the three and six months ended August 4, 2018, respectively, and unrealized gains of \$1.9 million and \$3.8 million in other income during the three and six months ended July 29, 2017, respectively. The projected benefit obligation was \$54.9 million and \$54.8 million as of August 4, 2018 and February 3, 2018, respectively, and was included in accrued expenses and other long-term liabilities in the Company's condensed consolidated balance sheets depending on the expected timing of payments. SERP benefit payments of \$0.4 million and \$0.8 million were made during the three and six months ended August 4, 2018, respectively. SERP benefit payments of \$0.4 million and \$0.8 million were made during the three and six months ended July 29, 2017, respectively.

Foreign Pension Plans

In certain foreign jurisdictions, primarily in Switzerland, the Company is required to guarantee the returns on Company-sponsored defined contribution plans in accordance with local regulations. These plans are typically government-mandated defined contribution plans that provide employees with a minimum investment return, and as such, are treated under pension accounting in accordance with authoritative guidance. Under the Swiss plan, both the Company and certain of its employees with annual earnings in excess of government determined amounts are required to make contributions into a fund managed by an independent investment fiduciary. The Company's contributions must be made in an amount at least equal to the employee's contribution. Minimum employee contributions are based on the respective employee's age, salary and gender.

As of August 4, 2018 and February 3, 2018, the foreign pension plans had a total projected benefit obligation of \$27.5 million and \$26.4 million, respectively, and plan assets held in independent investment fiduciaries of \$22.2 million and \$21.4 million, respectively. The net liability of \$5.3 million and \$5.0 million was included in other long-term liabilities in the Company's condensed consolidated balance sheets as of August 4, 2018 and February 3, 2018, respectively.

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The components of net periodic defined benefit pension cost for the three and six months ended August 4, 2018 and July 29, 2017 related to the Company's defined benefit plans are as follows (in thousands):

|   | Three Months Ended<br>August 4, 2018 |          |         |
|---|--------------------------------------|----------|---------|
|   | Foreign                              |          |         |
|   | SERP                                 | Pension  | Total   |
|   | Plans                                |          |         |
| Service cost  | \$—                                  | \$ 754   | \$754   |
| Interest cost   | 472                                  | 55       | 527     |
| Expected return on plan assets                        | —                                    | (75 )    | (75 )   |
| Net amortization of unrecognized prior service credit | —                                    | (7 )     | (7 )    |
| Net amortization of actuarial losses                  | 46                                   | 105      | 151     |
| Net periodic defined benefit pension cost             | \$518                                | \$ 832   | \$1,350 |
|   | Six Months Ended<br>August 4, 2018   |          |         |
|   | Foreign                              |          |         |
|   | SERP                                 | Pension  | Total   |
|   | Plans                                |          |         |
| Service cost  | \$—                                  | \$ 1,494 | \$1,494 |
| Interest cost   | 944                                  | 110      | 1,054   |
| Expected return on plan assets                        | —                                    | (149 )   | (149 )  |
| Net amortization of unrecognized prior service credit | —                                    | (14 )    | (14 )   |
| Net amortization of actuarial losses                  | 93                                   | 210      | 303     |
| Net periodic defined benefit pension cost             | \$1,037                              | \$ 1,651 | \$2,688 |
|   | Three Months Ended<br>July 29, 2017  |          |         |
|   | Foreign                              |          |         |
|   | SERP                                 | Pension  | Total   |
|   | Plans                                |          |         |
| Service cost  | \$—                                  | \$ 606   | \$606   |
| Interest cost   | 460                                  | 20       | 480     |
| Expected return on plan assets                        | —                                    | (46 )    | (46 )   |
| Net amortization of unrecognized prior service credit | —                                    | (6 )     | (6 )    |
| Net amortization of actuarial losses                  | 38                                   | 73       | 111     |
| Net periodic defined benefit pension cost             | \$498                                | \$ 647   | \$1,145 |
|   | Six Months Ended<br>July 29, 2017    |          |         |
|   | Foreign                              |          |         |
|   | SERP                                 | Pension  | Total   |
|   | Plans                                |          |         |
| Service cost  | \$—                                  | \$ 1,232 | \$1,232 |
| Interest cost   | 921                                  | 42       | 963     |
| Expected return on plan assets                        | —                                    | (95 )    | (95 )   |
| Net amortization of unrecognized prior service credit | —                                    | (13 )    | (13 )   |
| Net amortization of actuarial losses                  | 76                                   | 152      | 228     |
| Net periodic defined benefit pension cost             | \$997                                | \$ 1,318 | \$2,315 |

During the first quarter of fiscal 2019, the Company adopted new authoritative guidance which requires that the non-service components of net periodic defined benefit pension cost be presented outside of earnings (loss) from operations. The Company adopted this guidance on a retrospective basis and, as a result, reclassified approximately



\$0.5 million and \$1.1 million from SG&A expenses to other income (expense) for the three and six months ended July 29, 2017, respectively.

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## (14) Fair Value Measurements

Authoritative guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The guidance establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that can be accessed at the measurement date.

Level 2—Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (i.e. interest rates, yield curves, etc.) and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3—Unobservable inputs that reflect assumptions about what market participants would use in pricing the asset or liability. These inputs would be based on the best information available, including the Company's own data.

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of August 4, 2018 and February 3, 2018 (in thousands):

| Recurring Fair Value Measures       | Fair Value Measurements at Aug 4, 2018 |         |               | Fair Value Measurements at Feb 3, 2018 |         |               |
|-------------------------------------|--|---------|---------------|--|---------|---------------|
|                                     | Level 1                                | Level 2 | Level 3 Total | Level 1                                | Level 2 | Level 3 Total |
| Assets:                             |  |         |               |  |         |               |
| Foreign exchange currency contracts | \$-\$5,950                             | \$      | —\$5,950      | \$-\$51                                | \$      | —\$51         |
| Interest rate swap                  | —1,525                                 | —       | 1,525         | —1,460                                 | —       | 1,460         |
| Total                               | \$-\$7,475                             | \$      | —\$7,475      | \$-\$1,511                             | \$      | —\$1,511      |
| Liabilities:                        |  |         |               |  |         |               |
| Foreign exchange currency contracts | \$-\$1,011                             | \$      | —\$1,011      | \$-\$18,089                            | \$      | —\$18,089     |
| Deferred compensation obligations   | —14,484                                | —       | 14,484        | —13,476                                | —       | 13,476        |
| Total                               | \$-\$15,495                            | \$      | —\$15,495     | \$-\$31,565                            | \$      | —\$31,565     |

There were no transfers of financial instruments between the three levels of fair value hierarchy during the six months ended August 4, 2018 or during the year ended February 3, 2018.

Foreign exchange currency contracts are entered into by the Company principally to hedge the future payment of inventory and intercompany transactions by non-U.S. subsidiaries. Periodically, the Company may also use foreign exchange currency contracts to hedge the translation and economic exposures related to its net investments in certain of its international subsidiaries. The fair values of the Company's foreign exchange currency contracts are based on quoted foreign exchange forward rates at the reporting date. The fair values of the Company's interest rate swaps are based upon inputs corroborated by observable market data. Deferred compensation obligations to employees are adjusted based on changes in the fair value of the underlying employee-directed investments. Fair value of these obligations is based upon inputs corroborated by observable market data.

During fiscal 2018, the Company invested €0.5 million (\$0.5 million) in a private equity fund. During the six months ended August 4, 2018, the Company made additional investments totaling €0.9 million (\$1.1 million). As permitted in accordance with authoritative guidance, the Company uses net asset value per share as a practical expedient to measure the fair value of this investment and has not included this investment in the fair value hierarchy as disclosed above. During the three months ended August 4, 2018, the Company recorded an immaterial unrealized gain as a result of changes in the value of the private equity investment. During the six months ended August 4, 2018, the Company recorded an unrealized loss of €0.1 million (\$0.2 million) in other expense. As of August 4, 2018 and February 3, 2018, the Company included €1.2 million (\$1.4 million) and €0.5 million (\$0.6 million), respectively, in other assets in the Company's condensed consolidated balance sheet related to this investment. As of August 4, 2018, the Company had an unfunded commitment to invest an additional €3.6 million (\$4.2 million) in the private equity fund.



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The carrying amount of the Company's remaining financial instruments, which principally include cash and cash equivalents, trade receivables, accounts payable and accrued expenses, approximates fair value due to the relatively short maturity of such instruments. The fair values of the Company's debt instruments (see Note 9) are based on the amount of future cash flows associated with each instrument discounted using the Company's incremental borrowing rate. As of August 4, 2018 and February 3, 2018, the carrying value of all financial instruments was not materially different from fair value, as the interest rates on the Company's debt approximated rates currently available to the Company.

Long-Lived Assets

Long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment quarterly or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The majority of the Company's long-lived assets relate to its retail operations which consist primarily of regular retail and flagship locations. The Company considers each individual regular retail location as an asset group for impairment testing, which is the lowest level at which individual cash flows can be identified. The asset group includes leasehold improvements, furniture, fixtures and equipment, computer hardware and software and certain long-term security deposits and lease acquisition costs. The Company reviews regular retail locations in penetrated markets for impairment risk once the locations have been opened for at least one year in their current condition, or sooner as changes in circumstances require. The Company believes that waiting at least one year allows a location to reach a maturity level where a more comprehensive analysis of financial performance can be performed. The Company evaluates impairment risk for regular retail locations in new markets, where the Company is in the early stages of establishing its presence, once brand awareness has been established. The Company also evaluates impairment risk for retail locations that are expected to be closed in the foreseeable future. The Company has flagship locations which are used as a regional marketing tool to build brand awareness and promote the Company's current product. Impairment for these locations is tested at a reporting unit level similar to goodwill since they do not have separately identifiable cash flows.

An asset is considered to be impaired if the Company determines that the carrying value may not be recoverable based upon its assessment of the asset's ability to continue to generate earnings from operations and positive cash flow in future periods or if significant changes in the Company's strategic business objectives and utilization of the assets occurred. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the estimated fair value, which is determined based on discounted future cash flows. The impairment loss calculations require management to apply judgment in estimating future cash flows and the discount rates that reflect the risk inherent in future cash flows.

Future expected cash flows for assets in regular retail locations are based on management's estimates of future cash flows over the remaining lease period or expected life, if shorter. For expected location closures, the Company will evaluate whether it is necessary to shorten the useful life for any of the assets within the respective asset group. The Company will use this revised useful life when estimating the asset group's future cash flows. The Company considers historical trends, expected future business trends and other factors when estimating the future cash flow for each regular retail location. The Company also considers factors such as: the local environment for each regular retail location, including mall traffic and competition; the Company's ability to successfully implement strategic initiatives; and the ability to control variable costs such as cost of sales and payroll and, in some cases, renegotiate lease costs. The estimated cash flows used for this nonrecurring fair value measurement are considered a Level 3 input as defined above. If actual results are not consistent with the assumptions and judgments used in estimating future cash flows and asset fair values, there may be additional exposure to future impairment losses that could be material to the Company's results of operations.

The Company recorded asset impairment charges of \$3.0 million and \$3.7 million during the three and six months ended August 4, 2018, respectively, and \$1.2 million and \$4.0 million during the three and six months ended July 29, 2017, respectively. The asset impairment charges related primarily to the impairment of certain retail locations in Europe and North America resulting from under-performance and expected store closures.



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(15) Derivative Financial Instruments

Hedging Strategy

Foreign Exchange Currency Contracts

The Company operates in foreign countries, which exposes it to market risk associated with foreign currency exchange rate fluctuations. The Company has entered into certain forward contracts to hedge the risk of foreign currency rate fluctuations. The Company has elected to apply the hedge accounting rules in accordance with authoritative guidance for certain of these hedges.

The Company's primary objective is to hedge the variability in forecasted cash flows due to the foreign currency risk. Various transactions that occur primarily in Europe, Canada, South Korea, China and Mexico are denominated in U.S. dollars, British pounds and Russian roubles and thus are exposed to earnings risk as a result of exchange rate fluctuations when converted to their functional currencies. These types of transactions include U.S. dollar denominated purchases of merchandise and U.S. dollar and British pound denominated intercompany liabilities. In addition, certain operating expenses, tax liabilities and pension-related liabilities are denominated in Swiss francs and are exposed to earnings risk as a result of exchange rate fluctuations when converted to the functional currency. The Company enters into derivative financial instruments, including forward exchange currency contracts, to offset some, but not all, of the exchange risk on certain of these anticipated foreign currency transactions.

Periodically, the Company may also use foreign exchange currency contracts to hedge the translation and economic exposures related to its net investments in certain of its international subsidiaries.

Interest Rate Swap Agreements

The Company is exposed to interest rate risk on its floating-rate debt. The Company has entered into interest rate swap agreements to effectively convert its floating-rate debt to a fixed-rate basis. The principal objective of these contracts is to eliminate or reduce the variability of the cash flows in interest payments associated with the Company's floating-rate debt, thus reducing the impact of interest rate changes on future interest payment cash flows. The Company has elected to apply the hedge accounting rules in accordance with authoritative guidance for certain of these contracts. Refer to Note 9 for further information.

The impact of the credit risk of the counterparties to the derivative contracts is considered in determining the fair value of the foreign exchange currency contracts and interest rate swap agreements. As of August 4, 2018, credit risk has not had a significant effect on the fair value of the Company's foreign exchange currency contracts and interest rate swap agreements.

Hedge Accounting Policy

Foreign Exchange Currency Contracts

U.S. dollar forward contracts are used to hedge forecasted merchandise purchases over specific months. Changes in the fair value of these U.S. dollar forward contracts, designated as cash flow hedges, are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are recognized in cost of product sales in the period that approximates the time the hedged merchandise inventory is sold. The Company also hedges forecasted intercompany royalties over specific months. Changes in the fair value of these U.S. dollar forward contracts, designated as cash flow hedges, are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are recognized in other income (expense) in the period in which the royalty expense is incurred.

The Company has also used U.S. dollar forward contracts to hedge the net investments of certain of the Company's international subsidiaries over specific months. Changes in the fair value of these U.S. dollar forward contracts, designated as net investment hedges, are recorded in foreign currency translation adjustment as a component of accumulated other comprehensive income (loss) within stockholders' equity and are not recognized in earnings (loss) until the sale or liquidation of the hedged net investment.

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The Company also has foreign exchange currency contracts that are not designated as hedging instruments for accounting purposes. Changes in fair value of foreign exchange currency contracts not designated as hedging instruments are reported in net earnings (loss) as part of other income (expense).

**Interest Rate Swap Agreements**

Interest rate swap agreements are used to hedge the variability of the cash flows in interest payments associated with the Company's floating-rate debt. Changes in the fair value of interest rate swap agreements designated as cash flow hedges are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are amortized to interest expense over the term of the related debt.

Periodically, the Company may also enter into interest rate swap agreements that are not designated as hedging instruments for accounting purposes. Changes in the fair value of interest rate swap agreements not designated as hedging instruments are reported in net earnings (loss) as part of other income (expense).

**Summary of Derivative Instruments**

The fair value of derivative instruments in the condensed consolidated balance sheets as of August 4, 2018 and February 3, 2018 is as follows (in thousands):

|   | Derivative<br>Balance Sheet<br>Location          | Fair<br>Value<br>at<br>Aug 4,<br>2018 | Fair<br>Value at<br>Feb 3,<br>2018 |
|---|--|---------------------------------------|------------------------------------|
| <b>ASSETS:</b>                                      |  |                                       |                                    |
| Derivatives designated as hedging instruments:      |  |                                       |                                    |
| Cash flow hedges:                                   |  |                                       |                                    |
| Foreign exchange currency contracts                 | Other current assets/<br>Other assets            | \$4,224                               | \$41                               |
| Interest rate swap                                  | Other assets                                     | 1,525                                 | 1,460                              |
| Total derivatives designated as hedging instruments |  | 5,749                                 | 1,501                              |
| Derivatives not designated as hedging instruments:  |  |                                       |                                    |
| Foreign exchange currency contracts                 | Other current assets                             | 1,726                                 | 10                                 |
| Total   |  | \$7,475                               | \$1,511                            |
| <b>LIABILITIES:</b>                                 |  |                                       |                                    |
| Derivatives designated as hedging instruments:      |  |                                       |                                    |
| Cash flow hedges:                                   |  |                                       |                                    |
| Foreign exchange currency contracts                 | Accrued expenses/<br>Other long-term liabilities | \$528                                 | \$13,789                           |
| Derivatives not designated as hedging instruments:  |  |                                       |                                    |
| Foreign exchange currency contracts                 | Accrued expenses                                 | 483                                   | 4,300                              |
| Total   |  | \$1,011                               | \$18,089                           |

**Derivatives Designated as Hedging Instruments****Foreign Exchange Currency Contracts Designated as Cash Flow Hedges**

During the six months ended August 4, 2018, the Company purchased U.S. dollar forward contracts in Europe totaling US\$21.6 million that were designated as cash flow hedges. As of August 4, 2018, the Company had forward contracts outstanding for its European and Canadian operations of US\$103.7 million and US\$17.4 million, respectively, to hedge forecasted merchandise purchases, which are expected to mature over the next 12 months.

As of August 4, 2018, accumulated other comprehensive income (loss) related to foreign exchange currency contracts included a net unrealized loss of approximately \$1.3 million, net of tax, of which \$2.5 million will be recognized in cost of product sales over the following 12 months, at the then current values on a pre-tax basis, which can be different than the current quarter-end values.





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At February 3, 2018, the Company had forward contracts outstanding for its European and Canadian operations of US\$145.8 million and US\$38.7 million, respectively, that were designated as cash flow hedges.

**Interest Rate Swap Agreement Designated as Cash Flow Hedge**

During fiscal 2017, the Company entered into an interest rate swap agreement with a notional amount of \$21.5 million, designated as a cash flow hedge, to hedge the variability of cash flows in interest payments associated with the Company's floating-rate debt. This interest rate swap agreement matures in January 2026 and converts the nature of the Company's real estate secured term loan from LIBOR floating-rate debt to fixed-rate debt, resulting in a swap fixed rate of approximately 3.06%.

As of August 4, 2018, accumulated other comprehensive income (loss) related to the interest rate swap agreement included a net unrealized gain of approximately \$1.2 million, net of tax, which will be recognized in interest expense after the following 12 months, at the then current values on a pre-tax basis, which can be different than the current quarter-end values.

The following table summarizes the gains (losses) before taxes recognized on the derivative instruments designated as cash flow hedges in OCI and net earnings (loss) for the three and six months ended August 4, 2018 and July 29, 2017 (in thousands):

|   | Gain (Loss)<br>Recognized in<br>OCI |                 | Location of<br>Gain (Loss)<br>Reclassified from<br>Accumulated OCI<br>into Earnings (Loss) (1) | Gain (Loss)<br>Reclassified from<br>Accumulated OCI into<br>Earnings (Loss) |                 |
|---|-------------------------------------|-----------------|--|---|-----------------|
|   | Three Months<br>Ended               |                 |  | Three Months Ended  |                 |
|   | Aug 4,<br>2018                      | Jul 29,<br>2017 |  | Aug 4, 2018   | Jul 29,<br>2017 |
| Derivatives designated as cash flow hedges: |                                     |                 |  |   |                 |
| Foreign exchange currency contracts         | \$4,638                             | \$(14,673)      | Cost of product sales  | \$ (2,342 )   | \$ 661          |
| Foreign exchange currency contracts         | \$—                                 | \$(785 )        | Other income (expense)   | \$ —  | \$ 14           |
| Interest rate swap                          | \$37                                | \$(77 )         | Interest expense   | \$ 31   | \$(26 )         |
|   | Gain (Loss)<br>Recognized in<br>OCI |                 | Location of<br>Gain (Loss)<br>Reclassified from<br>Accumulated OCI<br>into Earnings (Loss) (1) | Gain (Loss)<br>Reclassified from<br>Accumulated OCI into<br>Earnings (Loss) |                 |
|   | Six Months Ended                    |                 |  | Six Months Ended  |                 |
|   | Aug 4,<br>2018                      | Jul 29,<br>2017 |  | Aug 4,<br>2018  | Jul 29,<br>2017 |
| Derivatives designated as cash flow hedges: |                                     |                 |  |   |                 |
| Foreign exchange currency contracts         | \$12,060                            | \$(13,816)      | Cost of product sales  | \$ (4,028 )   | \$ 1,279        |
| Foreign exchange currency contracts         | \$2                                 | \$(996 )        | Other income (expense)   | \$ (201 )   | \$ 93           |
| Interest rate swap                          | \$105                               | \$(277 )        | Interest expense   | \$ 39   | \$(62 )         |

(1) The Company recognized gains of \$0.8 million and \$1.4 million resulting from the ineffective portion related to foreign exchange currency contracts in interest income during the three and six months ended August 4, 2018, respectively. The Company recognized gains of \$0.9 million and \$1.5 million resulting from the ineffective portion related to foreign exchange currency contracts in interest income during the three and six months ended July 29, 2017, respectively. There was no ineffectiveness recognized related to the interest rate swap during the three and six months ended August 4, 2018 and July 29, 2017.

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The following table summarizes net after-tax derivative activity recorded in accumulated other comprehensive income (loss) (in thousands):

|  | Three Months Ended |                 | Six Months Ended |                 |
|--|--------------------|-----------------|------------------|-----------------|
|  | Aug 4,<br>2018     | Jul 29,<br>2017 | Aug 4,<br>2018   | Jul 29,<br>2017 |
| Beginning balance gain (loss)                        | \$ (6,285 )        | \$ 4,948        | \$ (14,369 )     | \$ 5,400        |
| Net gains (losses) from changes in cash flow hedges  | 4,111              | (13,093 )       | 10,579           | (12,969 )       |
| Net (gains) losses reclassified into earnings (loss) | 2,032              | (606 )          | 3,648            | (1,182 )        |
| Ending balance loss                                  | \$ (142 )          | \$ (8,751 )     | \$ (142 )        | \$ (8,751 )     |

**Foreign Exchange Currency Contracts Not Designated as Hedging Instruments**

As of August 4, 2018, the Company had euro foreign exchange currency contracts to purchase US\$38.0 million expected to mature over the next nine months and Canadian dollar foreign exchange currency contracts to purchase US\$7.7 million expected to mature over the next five months.

The following table summarizes the gains (losses) before taxes recognized on the derivative instruments not designated as hedging instruments in other income (expense) for the three and six months ended August 4, 2018 and July 29, 2017 (in thousands):

| Location of<br>Gain (Loss)<br>Recognized in Earnings<br>(Loss) | Gain (Loss)<br>Recognized in Earnings (Loss) |                 |                     |                 |
|--|--|-----------------|---------------------|-----------------|
|  | Three Months<br>Ended                        |                 | Six Months<br>Ended |                 |
|  | Aug 4,<br>2018                               | Jul 29,<br>2017 | Aug 4,<br>2018      | Jul 29,<br>2017 |

Derivatives not designated as hedging instruments:

|                                     |                        |          |            |          |            |
|-------------------------------------|------------------------|----------|------------|----------|------------|
| Foreign exchange currency contracts | Other income (expense) | \$ 2,216 | \$ (6,540) | \$ 5,906 | \$ (7,333) |
|-------------------------------------|------------------------|----------|------------|----------|------------|

At February 3, 2018, the Company had euro foreign exchange currency contracts to purchase US\$68.2 million and Canadian dollar foreign exchange currency contracts to purchase US\$17.6 million.

**(16) Subsequent Events****Dividends**

On August 29, 2018, the Company announced a regular quarterly cash dividend of \$0.225 per share on the Company's common stock. The cash dividend will be paid on September 28, 2018 to shareholders of record as of the close of business on September 12, 2018.

**ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.****General**

Unless the context indicates otherwise, when we refer to "we," "us," "our" or the "Company" in this Form 10-Q, we are referring to Guess?, Inc. ("GUESS?") and its subsidiaries on a consolidated basis.

**Important Factors Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q, including documents incorporated by reference herein, contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements may also be contained in the Company's other reports filed under the Securities Exchange Act of 1934, as amended, in its press releases and in other documents. In addition, from time-to-time, the Company through its management may make oral forward-looking statements. These statements relate to expectations, analyses and other information based on current plans, forecasts of future results and estimates of amounts not yet determinable. These statements also relate to our goals, future prospects, global cost reduction and profitability efforts, capital allocation plans, cash needs and current business strategies and strategic initiatives. These forward-looking statements are identified by their use of terms and phrases such as "anticipate," "believe," "continue," "could," "estimate," "expect," "goal," "intend," "may," "outlook," "pending," "plan," "predict," "project," "should," "strategy," "will," "would," and terms and phrases, including references to assumptions.



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Although we believe that the expectations reflected in any of our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed. These forward-looking statements may include, among other things, statements or assumptions relating to: our expected results of operations; the accuracy of data relating to, and anticipated levels of, future inventory and gross margins; anticipated cash requirements and sources; cost containment efforts; estimated charges; plans regarding store openings, closings, remodels and lease negotiations; plans regarding the opening or relocation of our distribution centers; plans regarding business growth, international expansion and capital allocation; plans regarding supply chain efficiencies and global planning and allocation; e-commerce, digital and omni-channel initiatives; business seasonality; results and risks of current and future legal proceedings, including the investigation by the European Commission regarding the potential breach of certain European Union competition rules by the Company; industry trends; consumer demands and preferences; competition; currency fluctuations and related impacts; estimated tax rates, including the impact of the Tax Reform and changes to provisional estimates; results of tax audits and other regulatory proceedings; the impact of recent accounting pronouncements; raw material and other inflationary cost pressures; consumer confidence; and general economic conditions. We do not intend, and undertake no obligation, to update our forward-looking statements to reflect future events or circumstances. Such statements involve risks and uncertainties, which may cause actual results to differ materially from those set forth in these statements. Important factors that could cause or contribute to such differences include those discussed under “Part I, Item 1A. Risk Factors” contained in the Company’s most recent Annual Report on Form 10-K for the fiscal year ended February 3, 2018 and in our other filings made from time-to-time with the SEC after the date of this report.

**Business Segments**

The Company’s businesses are grouped into five reportable segments for management and internal financial reporting purposes: Americas Retail, Americas Wholesale, Europe, Asia and Licensing. Management evaluates segment performance based primarily on revenues and earnings (loss) from operations before corporate performance-based compensation costs, net gains (losses) from lease terminations, asset impairment charges and restructuring charges, if any. The Americas Retail segment includes the Company’s retail and e-commerce operations in North and Central America and the Company’s retail operations in South America. The Americas Wholesale segment includes the Company’s wholesale operations in the Americas. The Europe segment includes the Company’s retail, e-commerce and wholesale operations in Europe and the Middle East. The Asia segment includes the Company’s retail, e-commerce and wholesale operations in Asia and the Pacific. The Licensing segment includes the worldwide licensing operations of the Company. The business segment operating results exclude corporate overhead costs, which consist of shared costs of the organization, net gains (losses) on lease terminations, asset impairment charges and restructuring charges. Corporate overhead costs are presented separately and generally include, among other things, the following unallocated corporate costs: accounting and finance, executive compensation, corporate performance-based compensation, facilities, global advertising and marketing, human resources, information technology and legal. Information regarding these segments is summarized in Note 8 to the Condensed Consolidated Financial Statements.

**Products**

We derive our net revenue from the sale of GUESS?, G by GUESS, GUESS Kids and MARCIANO apparel and our licensees’ products through our worldwide network of directly operated and licensed retail stores, wholesale customers and distributors, as well as our online sites. We also derive royalty revenue from worldwide licensing activities.

**Foreign Currency Volatility**

Since the majority of our international operations are conducted in currencies other than the U.S. dollar (primarily the Canadian dollar, Chinese yuan, euro, Japanese yen, Korean won, Mexican peso and Russian rouble), currency fluctuations can have a significant impact on the translation of our international revenues and earnings (loss) into U.S. dollar amounts.

In addition, some of our transactions that occur primarily in Europe, Canada, South Korea, China and Mexico are denominated in U.S. dollars, Swiss francs, British pounds and Russian roubles, exposing them to exchange

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rate fluctuations when these transactions (such as inventory purchases) are converted to their functional currencies. As a result, fluctuations in exchange rates can impact the operating margins of our foreign operations and reported earnings (loss), largely dependent on the transaction timing and magnitude during the period that the currency fluctuates. When these foreign exchange rates weaken versus the U.S. dollar at the time U.S. dollar denominated inventory is purchased relative to the purchases of the comparable period, our product margins could be unfavorably impacted if the relative sales prices do not change.

During the first six months of fiscal 2019, the average U.S. dollar rate was weaker against the Canadian dollar, Chinese yuan, euro, Japanese yen and the Korean won and stronger against the Mexican peso and the Russian rouble compared to the average rate in the same prior-year period. This had an overall favorable impact on the translation of our international revenues and an unfavorable impact on earnings from operations for the six months ended August 4, 2018 compared to the same prior-year period.

If the U.S. dollar strengthens relative to the respective fiscal 2018 foreign exchange rates, foreign exchange could negatively impact our revenues and operating results as well as our international cash and other balance sheet items during the remainder of fiscal 2019, particularly in Canada, Europe and Mexico. Alternatively, if the U.S. dollar weakens relative to the respective fiscal 2018 foreign exchange rates, our revenues and operating results as well as our other cash balance sheet items could be positively impacted by foreign currency fluctuations during the remainder of fiscal 2019, particularly in these regions.

The Company enters into derivative financial instruments to offset some, but not all, of the exchange risk on foreign currency transactions. For additional discussion regarding our exposure to foreign currency risk, forward contracts designated as hedging instruments and forward contracts not designated as hedging instruments, refer to “Item 3. Quantitative and Qualitative Disclosures About Market Risk.”

**Strategy**

The Company continues to remain focused on its five top strategic initiatives aimed at driving shareholder value, including: (i) elevating the quality of our sales organization and merchandising strategy to match the quality of our product and marketing; (ii) building a major business in Asia by unlocking the potential of the GUESS? brand in the region; (iii) creating a culture of purpose and accountability throughout the entire Company by implementing a more centralized organizational structure that reinforces our focus on sales and profitability; (iv) improving our cost structure (including supply chain and overhead); and (v) stabilizing and revitalizing our wholesale business. The following provides further details on the progress of these initiatives:

**Sales Organization and Merchandising Strategy.** We are executing on our plan to elevate the quality of our sales organization and merchandising strategy which includes: (1) elevating the product knowledge of our sales force; (2) building a more strategic and operational online organization in order to increase millennials’ engagement with our brand through digital marketing and social media; (3) taking steps such as investing in key stores and developing stronger replenishment, visual, stockroom and cost-control standards in order to improve our overall field and store structure; (4) implementing a more effective yearly retail calendar to better enable each store to fully capture local opportunities; (5) using feedback from our sales force to improve our collections and increase the number and effectiveness of our SKU’s; and (6) implementing a global pricing system with greater clarity and simplicity.

**Building our Asia Business.** We believe there continues to be significant potential in this region, particularly in mainland China, and plan to continue to allocate sufficient resources to fuel future growth.

**Transforming our Company’s Culture.** In order to generate global synergies, major decisions (including supply chain, technology, finance, stock allocation and communications) are becoming more centralized in the Company’s management team in Los Angeles. This centralized approach reinforces our focus on sales and profitability and fosters an environment of accountability and execution measured through key performance metrics.

**Improving our Cost Structure.** We plan to continue improving our cost structure by identifying synergies among departments and strengthening our supply chain. We are executing on the following supply chain initiatives to drive improvements in product costs: (i) developing a sourcing network in new territories that can offer better

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costs; (ii) consolidating and building strategic partnerships with high-quality suppliers to gain scale efficiencies; and (iii) implementing a fabric platforming process for each of the regional design offices to develop and utilize common fabrics across multiple styles creating a consistently high quality global offer for our wholesale and retail customers. We are also working to shorten our lead times through partnering with our suppliers, exercising agility in the production process and continuously searching for new suppliers and sourcing opportunities in reaction to the latest trends.

We are also focused on improving the profitability of our retail business in the Americas. As almost two-thirds of our leases in Americas Retail are up for renewal or have lease exit options over the next three years, we continue to have the flexibility to further optimize our retail footprint, as appropriate, in the coming years. However, we are not restricting ourselves to waiting for these dates to close stores or renegotiate rents. For example, during fiscal 2018, we modified certain of our leases held with a common landlord that had original lease end dates from fiscal 2018 to fiscal 2026 to now end in fiscal 2018 through fiscal 2020, in order to accelerate the reduction of our retail store footprint in North America.

**Stabilizing our Wholesale Business.** We are partnering with our wholesale customers to emphasize a retail-oriented mindset and encourage the adoption of best practices, including high quality visual merchandising, frequent rotation of products and maximization of inventory turns.

**Capital Allocation**

The Company's investments in capital for the full fiscal year 2019 are planned between \$90 million and \$95 million. The planned investments in capital are related primarily to retail and e-commerce expansion in Europe and Asia as well as continued investments in technology to support our long-term growth plans.

**Comparable Sales**

The Company reports National Retail Federation calendar comparable sales on a quarterly basis for our retail businesses which include the combined results from our brick-and-mortar retail stores and our e-commerce sites. We also separately report the impact of e-commerce sales on our comparable sales metric. As a result of our omni-channel strategy, our e-commerce business has become strongly intertwined with our brick-and-mortar retail store business. Therefore, we believe that the inclusion of e-commerce sales in our comparable sales metric provides a more meaningful representation of our retail results.

Sales from our brick-and-mortar retail stores include purchases that are initiated, paid for and fulfilled at our retail stores and directly operated concessions as well as merchandise that is reserved online but paid for and picked-up at our retail stores. Sales from our e-commerce sites include purchases that are initiated and paid for online and shipped from either our distribution centers or our retail stores as well as purchases that are initiated in a retail store, but due to inventory availability at the retail store, are ordered and paid for online and shipped from our distribution centers or picked-up from a different retail store.

Store sales are considered comparable after the store has been open for 13 full months. If a store remodel results in a square footage change of more than 15%, or involves a relocation or a change in store concept, the store sales are removed from the comparable store base until the store has been opened at its new size, in its new location or under its new concept for 13 full months. E-commerce sales are considered comparable after the online site has been operational in a country for 13 full months and exclude any related revenue from shipping fees.

Definitions and calculations of comparable sales used by the Company may differ from similarly titled measures reported by other companies.

**Other**

The Company operates on a 52/53-week fiscal year calendar, which ends on the Saturday nearest to January 31 of each year. The six months ended August 4, 2018 had the same number of days as the six months ended July 29, 2017.

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## Executive Summary

## Overview

Net earnings attributable to Guess?, Inc. increased 67.8% to \$25.5 million, or diluted earnings of \$0.31 per common share, for the quarter ended August 4, 2018, compared to \$15.2 million, or diluted earnings of \$0.18 per common share, for the quarter ended July 29, 2017.

During the quarter ended August 4, 2018, the Company recognized asset impairment charges of \$3.0 million and certain professional services and legal fees and related costs of \$2.0 million (or a combined \$3.9 million after considering the related tax benefit of \$1.1 million), or an unfavorable \$0.05 per share impact. Excluding the impact of these items, adjusted net earnings attributable to Guess?, Inc. were \$29.5 million and adjusted diluted earnings were \$0.36 per common share for the quarter ended August 4, 2018. During the quarter ended July 29, 2017, the Company recognized asset impairment charges of \$1.2 million (or \$0.8 million after considering the related tax benefit of \$0.4 million), or an unfavorable \$0.01 per share impact. Excluding the impact of the asset impairment charges and the related tax impact, adjusted net earnings attributable to Guess?, Inc. were \$16.1 million and adjusted diluted earnings were \$0.19 per common share for the quarter ended July 29, 2017. References to financial results excluding the impact of these items are non-GAAP measures and are addressed below under “Non-GAAP Measures.”

Highlights of the Company’s performance for the quarter ended August 4, 2018 compared to the same prior-year period are presented below, followed by a more comprehensive discussion under “Results of Operations”:

## Operations

Total net revenue increased 13.7% to \$645.9 million for the quarter ended August 4, 2018, compared to \$568.3 million in the same prior-year period. In constant currency, net revenue increased by 12.2%.

- Gross margin (gross profit as a percentage of total net revenue) increased 230 basis points to 37.1% for the quarter ended August 4, 2018, compared to 34.8% in the same prior-year period.

Selling, general and administrative (“SG&A”) expenses as a percentage of total net revenue (“SG&A rate”) increased 130 basis points to 31.7% for the quarter ended August 4, 2018, compared to 30.4% in the same prior-year period. SG&A expenses increased 18.2% to \$204.6 million for the quarter ended August 4, 2018, compared to \$173.0 million in the same prior-year period.

During the quarter ended August 4, 2018, the Company recognized asset impairment charges of \$3.0 million, compared to \$1.2 million in the same prior-year period.

Operating margin improved 70 basis points to 4.9% for the quarter ended August 4, 2018, compared to 4.2% in the same prior-year period. Higher asset impairment charges negatively impacted operating margin by 30 basis points during the quarter ended August 4, 2018 compared to the same prior-year period. Certain professional service and legal fees and related costs also negatively impacted operating margin by 30 basis points. Earnings from operations increased 34.0% to \$31.9 million for the quarter ended August 4, 2018, compared to \$23.8 million in the same prior-year period.

Other income, net (including interest income and expense) totaled \$1.6 million for the quarter ended August 4, 2018, compared to other expense, net of \$1.5 million in the same prior-year period.

The effective income tax rate improved by 570 basis points to 23.2% for the quarter ended August 4, 2018, compared to 28.9% in the same prior-year period.

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## Key Balance Sheet Accounts

The Company had \$219.1 million in cash and cash equivalents and \$0.4 million in restricted cash as of August 4, 2018, compared to \$316.5 million in cash and cash equivalents and \$1.3 million in restricted cash at July 29, 2017. The Company invested \$17.6 million to repurchase 1,118,808 of its common shares during the six months ended August 4, 2018. During the six months ended August 4, 2018, the Company also paid an additional \$6.0 million for shares that were repurchased during the fourth quarter of fiscal 2018 but were settled during the first quarter of fiscal 2019.

During the third quarter of fiscal 2018, the Company made up-front payments of approximately \$22 million related to the modification of certain lease agreements held with a common landlord in North America.

Accounts receivable, which consists of trade receivables relating primarily to the Company's wholesale business in Europe and, to a lesser extent, to its wholesale businesses in the Americas and Asia, royalty receivables relating to its licensing operations, credit card and retail concession receivables related to its retail businesses and certain other receivables, increased by \$49.8 million, or 21.3%, to \$283.4 million as of August 4, 2018, compared to \$233.6 million at July 29, 2017. On a constant currency basis, accounts receivable increased by \$55.4 million, or 23.7%, when compared to July 29, 2017.

Inventory increased by \$28.5 million, or 6.5%, to \$464.5 million as of August 4, 2018, compared to \$436.0 million at July 29, 2017. On a constant currency basis, inventory increased by \$37.7 million, or 8.6%, when compared to July 29, 2017.

## Global Store Count

In the second quarter of fiscal 2019, together with our partners, we opened 41 new stores worldwide, consisting of 19 stores in Europe and the Middle East, 17 stores in Asia and the Pacific, four stores in Central and South America and one store in Canada. Together with our partners, we closed 23 stores worldwide, consisting of 14 stores in Asia and the Pacific, four stores in the U.S., three stores in Central and South America, one store in Canada and one store in Europe and the Middle East.

We ended the second quarter of fiscal 2019 with 1,662 stores and 429 concessions worldwide, comprised as follows:

| Region                     | Stores |                   |                  | Concessions |                   |                  |
|----------------------------|--------|-------------------|------------------|-------------|-------------------|------------------|
|                            | Total  | Directly Operated | Partner Operated | Total       | Directly Operated | Partner Operated |
| United States              | 295    | 293               | 2                | 1           | —                 | 1                |
| Canada                     | 86     | 86                | —                | —           | —                 | —                |
| Central and South America  | 104    | 61                | 43               | 27          | 27                | —                |
| Total Americas             | 485    | 440               | 45               | 28          | 27                | 1                |
| Europe and the Middle East | 674    | 440               | 234              | 36          | 36                | —                |
| Asia and the Pacific       | 503    | 181               | 322              | 365         | 174               | 191              |
| Total                      | 1,662  | 1,061             | 601              | 429         | 237               | 192              |

Of the total 1,662 stores, 1,328 were GUESS? stores, 216 were GUESS? Accessories stores, 68 were G by GUESS stores and 50 were MARCIANO stores.



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## Results of Operations

Three Months Ended August 4, 2018 and July 29, 2017

## Consolidated Results

**Net Revenue.** Net revenue increased by \$77.6 million, or 13.7%, to \$645.9 million for the quarter ended August 4, 2018, compared to \$568.3 million for the quarter ended July 29, 2017. In constant currency, net revenue increased by 12.2% as currency translation fluctuations relating to our foreign operations favorably impacted net revenue by \$8.4 million compared to the same prior-year period. The increase was driven primarily by retail expansion in our international markets and, to a lesser extent, higher European wholesale shipments.

**Gross Margin.** Gross margin increased 230 basis points to 37.1% for the quarter ended August 4, 2018, compared to 34.8% in the same prior-year period, of which 190 basis points was due to higher overall product margins and 40 basis points was due to a lower occupancy rate. The higher overall product margins were driven primarily by lower markdowns in Americas Retail, partially offset by higher retail promotions in Europe. The lower occupancy rate was driven primarily by overall leveraging of expenses due mainly to higher European wholesale shipments and, to a lesser extent, cost reductions driven primarily by negotiated rent reductions in Americas Retail, partially offset by higher distribution costs resulting from the relocation of the Company's European distribution center.

**Gross Profit.** Gross profit increased by \$41.4 million, or 20.9%, to \$239.4 million for the quarter ended August 4, 2018, compared to \$198.0 million in the same prior-year period. The increase in gross profit, which included the unfavorable impact of currency translation, was due primarily to the favorable impact on gross profit from higher revenue. Currency translation fluctuations relating to our foreign operations unfavorably impacted gross profit by \$6.4 million.

The Company includes inbound freight charges, purchasing costs and related overhead, retail store occupancy costs, including rent and depreciation, and a portion of the Company's distribution costs related to its retail business in cost of product sales. The Company also includes net royalties received on the Company's inventory purchases of licensed product as a reduction to cost of product sales. The Company's gross margin may not be comparable to that of other entities since some entities include all of the costs related to their distribution in cost of product sales and others, like the Company, generally exclude wholesale-related distribution costs from gross margin, including them instead in SG&A expenses. Additionally, some entities include retail store occupancy costs in SG&A expenses and others, like the Company, include retail store occupancy costs in cost of product sales.

**SG&A Rate.** The Company's SG&A rate increased 130 basis points to 31.7% for the quarter ended August 4, 2018, compared to 30.4% in the same prior-year period. The Company's SG&A rate included the negative impact of 30 basis points from certain professional service and legal fees and related costs, which the Company otherwise would not have incurred as part of its business operations. Excluding these amounts, the Company's SG&A rate would have increased 100 basis points driven primarily by higher distribution costs resulting from the relocation of the Company's European distribution center.

**SG&A Expenses.** SG&A expenses increased by \$31.6 million, or 18.2%, to \$204.6 million for the quarter ended August 4, 2018, compared to \$173.0 million in the same prior-year period. The increase, which included the favorable impact of currency translation, was driven primarily by higher distribution costs resulting from the relocation of the Company's European distribution center and, to a lesser extent, higher selling and merchandising expenses and higher store selling expenses. Currency translation fluctuations relating to our foreign operations favorably impacted SG&A expenses by \$5.7 million.

**Asset Impairment Charges.** During the quarter ended August 4, 2018, the Company recognized asset impairment charges of \$3.0 million, compared to \$1.2 million in the same prior-year period. The higher asset impairment charges during the quarter ended August 4, 2018 related primarily to the impairment of certain retail locations in Europe and North America resulting from under-performance and expected store closures.

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**Operating Margin.** Operating margin increased 70 basis points to 4.9% for the quarter ended August 4, 2018, compared to 4.2% in the same prior-year period. Higher asset impairment charges negatively impacted operating margin by 30 basis points during the quarter ended August 4, 2018 compared to the same prior-year period. Certain professional service and legal fees and related costs negatively impacted operating margin by 30 basis points. Excluding the impact of these items, operating margin increased by 130 basis points compared to the same prior-year period. The positive impact of currency on operating margin for the quarter ended August 4, 2018 was approximately 10 basis points.

**Earnings from Operations.** Earnings from operations increased by \$8.1 million, or 34.0%, to \$31.9 million for the quarter ended August 4, 2018, compared to \$23.8 million in the same prior-year period. Currency translation fluctuations relating to our foreign operations unfavorably impacted earnings from operations by \$0.8 million.

**Interest Income, Net.** Interest income, net was \$0.3 million for the quarter ended August 4, 2018, compared to \$0.7 million for the quarter ended July 29, 2017 and includes the impact of hedge ineffectiveness of foreign exchange currency contracts designated as cash flow hedges.

**Other Income (Expense), Net.** Other income, net was \$1.4 million for the quarter ended August 4, 2018, compared to other expense, net of \$2.2 million in the same prior-year period. Other income, net in the quarter ended August 4, 2018 consisted primarily of net unrealized and realized mark-to-market revaluation gains on foreign exchange currency contracts and, to a lesser extent, unrealized gains on non-operating assets, partially offset by net unrealized mark-to-market revaluation losses on foreign currency balances. Other expense, net in the quarter ended July 29, 2017 consisted primarily of net unrealized and realized mark-to-market revaluation losses on foreign exchange currency contracts, partially offset by net unrealized mark-to-market revaluation gains on foreign currency balances and, to a lesser extent, unrealized gains on non-operating assets.

**Income Tax Expense.** Income tax expense for the quarter ended August 4, 2018 was \$7.8 million, or a 23.2% effective tax rate, compared to \$6.5 million, or a 28.9% effective tax rate, in the same prior-year period. Generally, income taxes for the interim periods are computed using the tax rate estimated to be applicable for the full fiscal year, adjusted for discrete items, which is subject to ongoing review and evaluation by management. The improvement in the effective income tax rate during the quarter ended August 4, 2018 compared to the same prior-year period was due primarily to lower losses in jurisdictions which the Company has valuation allowances and, to a lesser extent, the reversal of a valuation allowance on certain deferred taxes and the favorable impact from the enactment of the Tax Reform.

**Net Earnings Attributable to Noncontrolling Interests.** Net earnings attributable to noncontrolling interests were \$0.2 million, net of taxes, for the quarter ended August 4, 2018, compared to \$0.7 million, net of taxes, for the quarter ended July 29, 2017.

**Net Earnings Attributable to Guess?, Inc.** Net earnings attributable to Guess?, Inc. increased by \$10.3 million, or 67.8%, to \$25.5 million for the quarter ended August 4, 2018, compared to \$15.2 million in the same prior-year period. Diluted earnings per share increased to \$0.31 for the quarter ended August 4, 2018, compared to \$0.18 for the quarter ended July 29, 2017. During the quarter ended August 4, 2018, the Company recognized asset impairment charges of \$3.0 million and certain professional services and legal fees and related costs of \$2.0 million (or a combined \$3.9 million after considering the related tax benefit of \$1.1 million), or an unfavorable \$0.05 per share impact. Excluding the impact of these items, adjusted net earnings attributable to Guess?, Inc. were \$29.5 million and adjusted diluted earnings were \$0.36 per common share for the quarter ended August 4, 2018. We estimate that the positive impact of currency on diluted earnings per share for the quarter ended August 4, 2018 was approximately \$0.05 per share. During the quarter ended July 29, 2017, the Company recognized asset impairment charges of \$1.2 million (or \$0.8 million after considering the related tax benefit of \$0.4 million), or an unfavorable \$0.01 per share impact. Excluding the impact of the asset impairment charges and the related tax impact, adjusted net earnings attributable to Guess?, Inc. were \$16.1 million and adjusted diluted earnings were \$0.19 per common share for the quarter ended July 29, 2017. References to financial results excluding the impact of these items are non-GAAP measures and are addressed below under “Non-GAAP Measures.”



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## Information by Business Segment

The following table presents our net revenue and earnings (loss) from operations by segment for the three months ended August 4, 2018 and July 29, 2017 (dollars in thousands):

|  | Three Months Ended |              |           | %<br>Change |
|--|--------------------|--------------|-----------|-------------|
|  | Aug 4,<br>2018     | Jul 29, 2017 | Change    |             |
| Net revenue:                                       |                    |              |           |             |
| Americas Retail                                    | \$197,125          | \$201,188    | \$(4,063) | (2.0 %)     |
| Americas Wholesale                                 | 34,253             | 32,658       | 1,595     | 4.9         |
| Europe   | 311,998            | 255,215      | 56,783    | 22.2        |
| Asia   | 82,786             | 62,733       | 20,053    | 32.0        |
| Licensing (1) (2)                                  | 19,709             | 16,498       | 3,211     | 19.5        |
| Total net revenue (1) (2)                          | \$645,871          | \$568,292    | \$77,579  | 13.7 %      |
| Earnings (loss) from operations:                   |                    |              |           |             |
| Americas Retail (2) (3) (4)                        | \$5,582            | \$(3,555)    | \$9,137   | 257.0%      |
| Americas Wholesale (2) (3) (4)                     | 5,325              | 5,238        | 87        | 1.7         |
| Europe (3) (4) (5)                                 | 30,531             | 30,058       | 473       | 1.6         |
| Asia (3) (4)                                       | 1,634              | 2,441        | (807)     | (33.1)      |
| Licensing (2) (3) (4)                              | 17,437             | 14,389       | 3,048     | 21.2        |
| Total segment earnings from operations (2) (3) (5) | 60,509             | 48,571       | 11,938    | 24.6        |
| Corporate overhead (2) (3) (5)                     | (25,647)           | (23,551)     | (2,096)   | 8.9         |
| Asset impairment charges (3)                       | (2,981)            | (1,233)      | (1,748)   |             |
| Total earnings from operations (2) (5)             | \$31,881           | \$23,787     | \$8,094   | 34.0 %      |
| Operating margins:                                 |                    |              |           |             |
| Americas Retail (2) (3) (4)                        | 2.8                | % (1.8       | %)        |             |
| Americas Wholesale (2) (3) (4)                     | 15.5               | % 16.0       | %         |             |
| Europe (3) (4) (5)                                 | 9.8                | % 11.8       | %         |             |
| Asia (3) (4)                                       | 2.0                | % 3.9        | %         |             |
| Licensing (1) (2) (3) (4)                          | 88.5               | % 87.2       | %         |             |
| Total Company (1) (2) (5)                          | 4.9                | % 4.2        | %         |             |

During the fourth quarter of fiscal 2018, the Company reclassified net royalties received on the Company's inventory purchases of licensed product from net revenue to cost of product sales to reflect its treatment as a (1) reduction of the cost of such licensed product. Accordingly, net revenue for the three months ended July 29, 2017 has been adjusted to conform to the current period presentation. This reclassification had no impact on previously reported earnings from operations.

During the first quarter of fiscal 2019, the Company adopted a comprehensive new revenue recognition standard using a modified retrospective method that does not restate prior periods to be comparable to the current period presentation. The adoption of this guidance primarily impacted the presentation of advertising contributions received from the Company's licensees and the related advertising expenditures incurred by the Company. The adoption of this guidance resulted in an increase in net royalty revenue within the Company's Licensing segment of (2) \$2.1 million, as well as an increase in SG&A expenses in our Americas Retail, Americas Wholesale and Licensing segments as well as corporate overhead of \$0.5 million, \$0.2 million, \$0.2 million and \$0.5 million, respectively, during the three months ended August 4, 2018 compared to the same prior-year period. The net favorable impact on earnings from operations was approximately \$0.6 million during the three months ended August 4, 2018 compared to the same prior-year period. Refer to Note 1 to the Condensed Consolidated Financial Statements for more information regarding the impact from the adoption of this new standard.

(3)

During the third quarter of fiscal 2018, segment results were adjusted to exclude corporate performance-based compensation costs, net gains (losses) on lease terminations and asset impairment charges due to the fact that these items are no longer included in the segment results provided to the Company's chief operating decision maker in order to allocate resources and assess performance. Accordingly, segment results have been adjusted for the three months ended July 29, 2017 to conform to the current period presentation.

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During the first quarter of fiscal 2019, the Company changed the segment accountability for funds received from licensees on the Company's purchases of its licensed products. These amounts were treated as a reduction of cost of (4) product sales within the Licensing segment but now are considered in the results of the segments that control the respective purchases for purposes of segment performance evaluation. Accordingly, segment results for the three months ended July 29, 2017 have been adjusted to conform to the current period presentation.

During the first quarter of fiscal 2019, the Company adopted new authoritative guidance which requires that the (5) non-service components of net periodic defined benefit pension cost be presented outside of earnings (loss) from operations. Accordingly, earnings from operations and segment results for the three months ended July 29, 2017 have been adjusted to conform to the current period presentation.

**Americas Retail**

Net revenue from our Americas Retail segment decreased by \$4.1 million, or 2.0%, to \$197.1 million for the quarter ended August 4, 2018, from \$201.2 million in the same prior-year period. In constant currency, net revenue decreased by 2.0%, driven primarily by store closures, partially offset by positive comparable sales. The store base for the U.S. and Canada decreased by an average of 50 net stores during the quarter ended August 4, 2018 compared to the same prior-year period, resulting in a 9.5% net decrease in average square footage. Comparable sales (including e-commerce) increased 3% in U.S. dollars and constant currency. The inclusion of our e-commerce sales had a minimal impact on the comparable sales percentage in U.S. dollars and constant currency. Currency translation fluctuations relating to our non-U.S. retail stores and e-commerce sites had a minimal impact on net revenue during the quarter ended August 4, 2018.

Operating margin improved 460 basis points to 2.8% for the quarter ended August 4, 2018, compared to negative 1.8% in the same prior-year period, due to higher gross margins, partially offset by a higher SG&A rate. The higher gross margins were driven primarily by lower markdowns and, to a lesser extent, cost reductions due primarily to negotiated rent reductions. The higher SG&A rate was driven primarily by higher store selling expenses.

Earnings from operations from our Americas Retail segment were \$5.6 million for the quarter ended August 4, 2018, compared to loss from operations of \$3.6 million in the same prior-year period. The improvement reflects the favorable impact on earnings from lower occupancy costs driven primarily by negotiated rent reductions and, to a lesser extent, higher product margins.

**Americas Wholesale**

Net revenue from our Americas Wholesale segment increased by \$1.6 million, or 4.9%, to \$34.3 million for the quarter ended August 4, 2018, compared to \$32.7 million in the same prior-year period. In constant currency, net revenue increased by 6.8%, driven primarily by higher shipments in our Mexican and U.S. wholesale businesses. Currency translation fluctuations relating to our non-U.S. wholesale businesses unfavorably impacted net revenue by \$0.6 million.

Operating margin decreased 50 basis points to 15.5% for the quarter ended August 4, 2018, from 16.0% in the same prior-year period, due primarily to lower gross margins driven primarily by the liquidation of aged inventory.

Earnings from operations from our Americas Wholesale segment increased by \$0.1 million, or 1.7%, to \$5.3 million for the quarter ended August 4, 2018, compared to \$5.2 million in the same prior-year period.

**Europe**

Net revenue from our Europe segment increased by \$56.8 million, or 22.2%, to \$312.0 million for the quarter ended August 4, 2018, compared to \$255.2 million in the same prior-year period. In constant currency, net revenue increased by 19.4%, driven primarily by the favorable impact from higher shipments in our European wholesale business and, to a lesser extent, retail expansion. As of August 4, 2018, we directly operated 440 stores in Europe compared to 363 stores at July 29, 2017, excluding concessions, which represents a 21.2% increase over the same prior-year period. Comparable sales (including e-commerce) increased 5% in U.S. dollars and 2% in constant currency compared to the same prior-year period. The inclusion of our e-commerce sales increased the comparable

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sales percentage by 4% in U.S. dollars and 3% in constant currency. Currency translation fluctuations relating to our European operations favorably impacted net revenue by \$7.3 million.

Operating margin decreased 200 basis points to 9.8% for the quarter ended August 4, 2018, from 11.8% in the same prior-year period, driven primarily by lower gross margins and, to a lesser extent, a higher SG&A rate. The lower gross margins were due primarily to higher distribution costs resulting from the relocation of the Company's European distribution center and, to a lesser extent, higher retail promotions, partially offset by higher initial markups and, to a lesser extent, overall leveraging of occupancy costs resulting from higher wholesale shipments. The higher SG&A rate was driven primarily by higher distribution costs resulting from the relocation of the Company's European distribution center, partially offset by overall leveraging of expenses resulting from higher wholesale shipments.

Earnings from operations from our Europe segment increased by \$0.5 million, or 1.6%, to \$30.5 million for the quarter ended August 4, 2018, compared to \$30.1 million in the same prior-year period, driven primarily by the favorable impact on earnings from higher revenue, partially offset by higher distribution costs resulting from the relocation of the Company's European distribution center. Currency translation fluctuations relating to our European operations unfavorably impacted earnings from operations by \$0.9 million.

#### Asia

Net revenue from our Asia segment increased by \$20.1 million, or 32.0%, to \$82.8 million for the quarter ended August 4, 2018, compared to \$62.7 million in the same prior-year period. In constant currency, net revenue increased by 29.0%, driven primarily by retail expansion and, to a lesser extent, positive comparable sales. As of August 4, 2018, we and our partners operated 503 stores and 365 concessions in Asia, compared to 480 stores and 374 concessions at July 29, 2017. As of August 4, 2018, we directly operated 181 stores and 174 concessions in Asia, compared to 109 directly operated stores and 188 concessions at July 29, 2017. Comparable sales (including e-commerce) increased 17% in U.S. dollars and 14% in constant currency. The inclusion of our e-commerce sales increased the comparable sales percentage by 5% in U.S. dollars and constant currency. Currency translation fluctuations relating to our Asian operations favorably impacted net revenue by \$1.8 million.

Operating margin decreased 190 basis points to 2.0% for the quarter ended August 4, 2018, from 3.9% in the same prior-year period, due to a higher SG&A rate, partially offset by higher gross margins. The higher SG&A rate was driven by higher expenses due primarily to retail expansion in Australia. The higher gross margins were driven primarily by overall leveraging of occupancy costs and, to a lesser extent, the favorable impact of business mix on product margins.

Earnings from operations from our Asia segment decreased by \$0.8 million, or 33.1%, to \$1.6 million for the quarter ended August 4, 2018, from \$2.4 million in the same prior-year period, driven primarily by the unfavorable impact on earnings from higher SG&A expenses and, to a lesser extent, higher occupancy costs due to retail expansion, partially offset by the favorable impact on earnings from revenue.

#### Licensing

Net royalty revenue from our Licensing segment increased by \$3.2 million, or 19.5%, to \$19.7 million for the quarter ended August 4, 2018, compared to \$16.5 million in the same prior-year period. This increase was driven primarily by the impact from the adoption of new accounting guidance for revenue recognition which increased net royalty revenue by \$2.1 million, or 12.4%, during the quarter ended August 4, 2018 compared to the same prior-year period.

Earnings from operations from our Licensing segment increased by \$3.0 million, or 21.2%, to \$17.4 million for the quarter ended August 4, 2018, compared to \$14.4 million in the same prior-year period. The increase was driven by the favorable impact to earnings from higher revenue.

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## Corporate Overhead

Unallocated corporate overhead increased by \$2.1 million to \$25.6 million for the quarter ended August 4, 2018, compared to \$23.6 million in the same prior-year period, driven primarily by \$2.0 million in certain professional service and legal fees and related costs, which the Company otherwise would not have incurred as part of its business operations.

Six Months Ended August 4, 2018 and July 29, 2017

## Consolidated Results

**Net Revenue.** Net revenue increased by \$144.5 million, or 14.1%, to \$1.17 billion for the six months ended August 4, 2018, compared to \$1.02 billion for the six months ended July 29, 2017. In constant currency, net revenue increased by 10.2% as currency translation fluctuations relating to our foreign operations favorably impacted net revenue by \$40.3 million compared to the same prior-year period. The increase was driven primarily by retail expansion in our international markets and, to a lesser extent, higher European wholesale shipments.

**Gross Margin.** Gross margin increased 190 basis points to 35.4% for the six months ended August 4, 2018, compared to 33.5% in the same prior-year period, of which 160 basis points was due to higher overall product margins and 30 basis points was due to a lower occupancy rate. The higher overall product margins were driven primarily by lower markdowns in Americas Retail, partially offset by higher retail promotions in Europe. The lower occupancy rate was driven primarily by overall global leveraging of expenses and, to a lesser extent, cost reductions due primarily to negotiated rent reductions in Americas Retail, partially offset by higher distribution costs resulting from the relocation of the Company's European distribution center.

**Gross Profit.** Gross profit increased by \$70.7 million, or 20.6%, to \$413.4 million for the six months ended August 4, 2018, compared to \$342.7 million in the same prior-year period. The increase in gross profit, which included the unfavorable impact of currency translation, was due primarily to the favorable impact on gross profit from higher revenue. Currency translation fluctuations relating to our foreign operations unfavorably impacted gross profit by \$1.0 million.

**SG&A Rate.** The Company's SG&A rate increased 130 basis points to 34.5% for the six months ended August 4, 2018, compared to 33.2% in the same prior-year period. The Company's SG&A rate included the negative impact of 50 basis points from certain professional service and legal fees and related costs, which the Company otherwise would not have incurred as part of its business operations. Excluding these amounts, the Company's SG&A rate would have increased 80 basis points driven primarily by higher distribution costs resulting from the relocation of the Company's European distribution center.

**SG&A Expenses.** SG&A expenses increased by \$62.9 million, or 18.5%, to \$402.8 million for the six months ended August 4, 2018, compared to \$339.9 million in the same prior-year period. The increase, which included the unfavorable impact of currency translation, was driven primarily by higher distribution costs resulting from the relocation of the Company's European distribution center and, to a lesser extent, higher selling and merchandising expenses. Currency translation fluctuations relating to our foreign operations unfavorably impacted SG&A expenses by \$3.7 million.

**Net Gains on Lease Terminations.** During the six months ended August 4, 2018, the Company recognized net gains on lease terminations of \$0.2 million related primarily to the early termination of certain lease agreements in North America. There were no net gains on lease terminations during the six months ended July 29, 2017.

**Asset Impairment Charges.** During the six months ended August 4, 2018, the Company recognized asset impairment charges of \$3.7 million, compared to \$4.0 million in the same prior-year period.

**Operating Margin.** Operating margin increased 70 basis points to 0.6% for the six months ended August 4, 2018, compared to negative 0.1% in the same prior-year period. Certain professional service and legal fees and related costs negatively impacted operating margin by 50 basis points. This was partially offset by the favorable impact on operating margin from lower asset impairment charges of 10 basis points during the six months ended August 4, 2018 compared to the same prior-year period. Net gains on lease terminations had a minimal impact



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on operating margin for the six months ended August 4, 2018. Excluding the impact of these items, operating margin improved by 110 basis points compared to the same prior-year period. The negative impact of currency on operating margin for the six months ended August 4, 2018 was approximately 20 basis points.

**Earnings (Loss) from Operations.** Earnings from operations were \$7.0 million for the six months ended August 4, 2018, compared to loss from operations of \$1.2 million in the same prior-year period. Currency translation fluctuations relating to our foreign operations unfavorably impacted earnings from operations by \$4.8 million.

**Interest Income, Net.** Interest income, net was \$0.5 million for the six months ended August 4, 2018, compared to \$1.2 million for the six months ended July 29, 2017 and includes the impact of hedge ineffectiveness of foreign exchange currency contracts designated as cash flow hedges.

**Other Expense, Net.** Other expense, net was \$1.3 million for the six months ended August 4, 2018, compared to \$0.3 million in the same prior-year period. Other expense, net in the six months ended August 4, 2018 consisted primarily of net unrealized mark-to-market revaluation losses on foreign currency balances, partially offset by net unrealized and realized mark-to-market revaluation gains on foreign exchange currency contracts. Other expense, net in the six months ended July 29, 2017 consisted primarily of net unrealized and realized mark-to-market revaluation losses on foreign exchange currency contracts, partially offset by net unrealized mark-to-market revaluation gains on foreign currency balances and, to a lesser extent, unrealized gains on non-operating assets.

**Income Tax Expense.** Income tax expense for the six months ended August 4, 2018 was \$1.5 million, or a 24.0% effective tax rate, compared to \$5.1 million, or a negative 1,706.1% effective tax rate, in the same prior-year period. Generally, income taxes for the interim periods are computed using the tax rate estimated to be applicable for the full fiscal year, adjusted for discrete items, which is subject to ongoing review and evaluation by management. The improvement in the effective income tax rate during the six months ended August 4, 2018 was due primarily to lower losses in jurisdictions which the Company has valuation allowances and, to a lesser extent, the reversal of a valuation allowance on certain deferred taxes and the favorable impact from the enactment of the Tax Reform.

**Net Earnings Attributable to Noncontrolling Interests.** Net earnings attributable to noncontrolling interests were \$0.4 million, net of taxes, for the six months ended August 4, 2018, compared to \$0.7 million, net of taxes, for the six months ended July 29, 2017.

**Net Earnings (Loss) Attributable to Guess?, Inc.** Net earnings attributable to Guess?, Inc. were \$4.3 million for the six months ended August 4, 2018, compared to net loss attributable to Guess?, Inc. of \$6.1 million in the same prior-year period. Diluted earnings per share increased to \$0.05 for the six months ended August 4, 2018, from diluted loss per share of \$0.08 for the six months ended July 29, 2017. During the six months ended August 4, 2018, the Company recognized net gains on lease terminations of \$0.2 million, asset impairment charges of \$3.7 million and certain professional services and legal fees and related costs of \$5.8 million (or a combined \$7.3 million after considering the related tax benefit of \$2.1 million), or an unfavorable \$0.09 per share impact. Excluding the impact of these items, adjusted net earnings attributable to Guess?, Inc. were \$11.6 million and adjusted diluted earnings were \$0.14 per common share during the six months ended August 4, 2018. We estimate that the positive impact of currency on diluted earnings per share for the six months ended August 4, 2018 was approximately \$0.02 per share. During the six months ended July 29, 2017, the Company recognized asset impairment charges of \$4.0 million (or \$2.8 million after considering the related tax benefit of \$1.2 million), or an unfavorable \$0.04 per share impact. Excluding the impact of the asset impairment charges and the related tax impact, adjusted net loss attributable to Guess?, Inc. was \$3.3 million and adjusted diluted loss was \$0.04 per common share during the six months ended July 29, 2017. References to financial results excluding the impact of these items are non-GAAP measures and are addressed below under “Non-GAAP Measures.”

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## Information by Business Segment

The following table presents our net revenue and earnings (loss) from operations by segment for the six months ended August 4, 2018 and July 29, 2017 (dollars in thousands):

|  | Six Months Ended |              | Change     | %<br>Change |
|--|------------------|--------------|------------|-------------|
|  | Aug 4, 2018      | Jul 29, 2017 |            |             |
| Net revenue:                                       |                  |              |            |             |
| Americas Retail                                    | \$368,465        | \$374,882    | \$(6,417 ) | (1.7 )%     |
| Americas Wholesale                                 | 74,932           | 68,515       | 6,417      | 9.4         |
| Europe   | 517,433          | 420,603      | 96,830     | 23.0        |
| Asia   | 166,837          | 126,114      | 40,723     | 32.3        |
| Licensing (1) (2)                                  | 39,493           | 32,523       | 6,970      | 21.4        |
| Total net revenue (1) (2)                          | \$1,167,160      | \$1,022,637  | \$144,523  | 14.1 %      |
| Earnings (loss) from operations:                   |                  |              |            |             |
| Americas Retail (2) (3) (4)                        | \$(98 )          | \$(25,136 )  | \$25,038   | 99.6 %      |
| Americas Wholesale (2) (3) (4)                     | 11,351           | 12,221       | (870 )     | (7.1 )      |
| Europe (3) (4) (5)                                 | 10,198           | 29,052       | (18,854 )  | (64.9 )     |
| Asia (3) (4)                                       | 5,699            | 2,780        | 2,919      | 105.0       |
| Licensing (2) (3) (4)                              | 34,923           | 27,850       | 7,073      | 25.4        |
| Total segment earnings from operations (2) (3) (5) | 62,073           | 46,767       | 15,306     | 32.7        |
| Corporate overhead (2) (3) (5)                     | (51,492 )        | (43,960 )    | (7,532 )   | 17.1        |
| Net gains on lease terminations (3)                | 152              | —            | 152        |             |
| Asset impairment charges (3)                       | (3,740 )         | (3,995 )     | 255        |             |
| Total earnings (loss) from operations (2) (5)      | \$6,993          | \$(1,188 )   | \$8,181    | 688.6%      |
| Operating margins:                                 |                  |              |            |             |
| Americas Retail (2) (3) (4)                        | (0.0 )%          | (6.7 )%      |            |             |
| Americas Wholesale (2) (3) (4)                     | 15.1 %           | 17.8 %       |            |             |
| Europe (3) (4) (5)                                 | 2.0 %            | 6.9 %        |            |             |
| Asia (3) (4)                                       | 3.4 %            | 2.2 %        |            |             |
| Licensing (1) (2) (3) (4)                          | 88.4 %           | 85.6 %       |            |             |
| Total Company (1) (2) (5)                          | 0.6 %            | (0.1 )%      |            |             |

During the fourth quarter of fiscal 2018, the Company reclassified net royalties received on the Company's inventory purchases of licensed product from net revenue to cost of product sales to reflect its treatment as a (1) reduction of the cost of such licensed product. Accordingly, net revenue for the six months ended July 29, 2017 has been adjusted to conform to the current period presentation. This reclassification had no impact on previously reported loss from operations.

During the first quarter of fiscal 2019, the Company adopted a comprehensive new revenue recognition standard using a modified retrospective method that does not restate prior periods to be comparable to the current period presentation. The adoption of this guidance primarily impacted the presentation of advertising contributions received from the Company's licensees and the related advertising expenditures incurred by the Company. The adoption of this guidance resulted in an increase in net royalty revenue within the Company's Licensing segment of (2) \$4.4 million, as well as an increase in SG&A expenses in our Americas Retail, Americas Wholesale and Licensing segments as well as corporate overhead of \$2.3 million, \$0.9 million, \$0.4 million and \$1.1 million, respectively, during the six months ended August 4, 2018 compared to the same prior-year period. The net unfavorable impact on earnings from operations was approximately \$0.4 million during the six months ended August 4, 2018 compared to the same prior-year period. Refer to Note 1 to the Condensed Consolidated Financial Statements for more information regarding the impact from the adoption of this new standard.

(3)

During the third quarter of fiscal 2018, segment results were adjusted to exclude corporate performance-based compensation costs, net gains (losses) on lease terminations and asset impairment charges due to the fact that these items are no longer included in the segment results provided to the Company's chief operating decision maker in order to allocate resources and assess performance. Accordingly, segment results have been adjusted for the six months ended July 29, 2017 to conform to the current period presentation.

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During the first quarter of fiscal 2019, the Company changed the segment accountability for funds received from licensees on the Company's purchases of its licensed products. These amounts were treated as a reduction of cost of (4) product sales within the Licensing segment but now are considered in the results of the segments that control the respective purchases for purposes of segment performance evaluation. Accordingly, segment results for the six months ended July 29, 2017 have been adjusted to conform to the current period presentation.

During the first quarter of fiscal 2019, the Company adopted new authoritative guidance which requires that the (5) non-service components of net periodic defined benefit pension cost be presented outside of earnings (loss) from operations. Accordingly, loss from operations and segment results for the six months ended July 29, 2017 have been adjusted to conform to the current period presentation.

**Americas Retail**

Net revenue from our Americas Retail segment decreased by \$6.4 million, or 1.7%, to \$368.5 million for the six months ended August 4, 2018, from \$374.9 million in the same prior-year period. In constant currency, net revenue decreased by 2.1%, driven primarily by store closures, partially offset by positive comparable sales. The store base for the U.S. and Canada decreased by an average of 53 net stores during the six months ended August 4, 2018 compared to the same prior-year period, resulting in a 10.1% net decrease in average square footage. Comparable sales (including e-commerce) increased 2% in U.S. dollars and constant currency. The inclusion of our e-commerce sales had a minimal impact on the comparable sales percentage in U.S. dollars and constant currency. Currency translation fluctuations relating to our non-U.S. retail stores and e-commerce sites favorably impacted net revenue by \$1.4 million.

Operating margin improved 670 basis points to relatively breakeven for the six months ended August 4, 2018, compared to negative 6.7% in the same prior-year period. This improvement was driven primarily by higher gross margins due to lower markdowns and, to a lesser extent, cost reductions due primarily to negotiated rent reductions. Loss from operations from our Americas Retail segment improved by \$25.0 million, or 99.6%, to \$0.1 million for the six months ended August 4, 2018, compared to \$25.1 million in the same prior-year period. The improvement reflects the favorable impact on earnings from lower occupancy costs driven primarily by negotiated rent reductions and, to a lesser extent, higher product margins.

**Americas Wholesale**

Net revenue from our Americas Wholesale segment increased by \$6.4 million, or 9.4%, to \$74.9 million for the six months ended August 4, 2018, compared to \$68.5 million in the same prior-year period. In constant currency, net revenue increased by 9.1%, driven primarily by higher shipments in our U.S., Mexican and Canadian wholesale businesses. Currency translation fluctuations relating to our non-U.S. wholesale businesses favorably impacted net revenue by \$0.2 million.

Operating margin decreased 270 basis points to 15.1% for the six months ended August 4, 2018, from 17.8% in the same prior-year period, due primarily to lower gross margins driven primarily by the liquidation of aged inventory. Earnings from operations from our Americas Wholesale segment decreased by \$0.9 million, or 7.1%, to \$11.4 million for the six months ended August 4, 2018, from \$12.2 million in the same prior-year period, driven primarily by the unfavorable impact on earnings from lower gross margins.

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## Europe

Net revenue from our Europe segment increased by \$96.8 million, or 23.0%, to \$517.4 million for the six months ended August 4, 2018, compared to \$420.6 million in the same prior-year period. In constant currency, net revenue increased by 15.4%, driven primarily by the favorable impact from retail expansion and, to a lesser extent, from higher shipments in our European wholesale business. Comparable sales (including e-commerce) increased 9% in U.S. dollars and 2% in constant currency compared to the same prior-year period. The inclusion of our e-commerce sales increased the comparable sales percentage by 5% in U.S. dollars and constant currency. Currency translation fluctuations relating to our European operations favorably impacted net revenue by \$32.2 million.

Operating margin decreased 490 basis points to 2.0% for the six months ended August 4, 2018, from 6.9% in the same prior-year period, driven primarily by lower gross margins and, to a lesser extent, a higher SG&A rate. The lower gross margins were due primarily to higher distribution costs resulting from the relocation of the Company's European distribution center and, to a lesser extent, higher retail promotions. The higher SG&A rate was driven by higher distribution costs resulting from the relocation of the Company's European distribution center, partially offset by overall leveraging of expenses resulting from higher wholesale shipments.

Earnings from operations from our Europe segment decreased by \$18.9 million, or 64.9%, to \$10.2 million for the six months ended August 4, 2018, compared to \$29.1 million in the same prior-year period. The decrease was driven primarily by the higher distribution costs resulting from the relocation of the Company's European distribution center. Currency translation fluctuations relating to our European operations unfavorably impacted earnings from operations by \$4.9 million.

## Asia

Net revenue from our Asia segment increased by \$40.7 million, or 32.3%, to \$166.8 million for the six months ended August 4, 2018, compared to \$126.1 million in the same prior-year period. In constant currency, net revenue increased by 27.1%, driven primarily by retail expansion and, to a lesser extent, positive comparable sales. Comparable sales (including e-commerce) increased 20% in U.S. dollars and 15% in constant currency compared to the same prior-year period. The inclusion of our e-commerce sales increased the comparable sales percentage by 5% in U.S. dollars and constant currency. Currency translation fluctuations relating to our Asian operations favorably impacted net revenue by \$6.6 million.

Operating margin increased 120 basis points to 3.4% for the six months ended August 4, 2018, compared to 2.2% in the same prior-year period, due to higher gross margins, partially offset by a higher SG&A rate. The higher gross margins were due primarily to overall leveraging of occupancy costs. The higher SG&A rate was driven by higher expenses due primarily to retail expansion in Australia.

Earnings from operations from our Asia segment increased by \$2.9 million, or 105.0%, to \$5.7 million for the six months ended August 4, 2018, compared to \$2.8 million in the same prior-year period, driven primarily by the favorable impact on earnings from higher revenue, partially offset by higher SG&A expenses and, to a lesser extent, higher occupancy costs due to retail expansion.

## Licensing

Net royalty revenue from our Licensing segment increased by \$7.0 million, or 21.4%, to \$39.5 million for the six months ended August 4, 2018, compared to \$32.5 million in the same prior-year period. This increase was driven primarily by the impact from the adoption of new accounting guidance for revenue recognition which increased net royalty revenue by \$4.4 million, or 13.4%, during the six months ended August 4, 2018 compared to the same prior-year period.

Earnings from operations from our Licensing segment increased by \$7.1 million, or 25.4%, to \$34.9 million for the six months ended August 4, 2018, compared to \$27.9 million in the same prior-year period. The increase was driven by the favorable impact to earnings from higher revenue.

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## Corporate Overhead

Unallocated corporate overhead increased by \$7.5 million to \$51.5 million for the six months ended August 4, 2018, compared to \$44.0 million in the same prior-year period, driven primarily by \$5.8 million in certain professional service and legal fees and related costs, which the Company otherwise would not have incurred as part of its business operations.

## Non-GAAP Measures

The Company's reported financial results are presented in accordance with GAAP. The reported net earnings attributable to Guess?, Inc. and diluted earnings per share for the three and six months ended August 4, 2018 reflect the impact of net gains on lease terminations, asset impairment charges, certain professional service and legal fees and related costs and the tax effects of these adjustments, where applicable. The reported net earnings (loss) attributable to Guess?, Inc. and diluted earnings (loss) per share for the three and six months ended July 29, 2017 reflect the impact of asset impairment charges and the related tax impact. These items affect the comparability of the Company's reported results. The financial results are also presented on a non-GAAP basis, as defined in Section 10(e) of Regulation S-K of the SEC, to exclude the effect of these items. The Company believes that these items are not indicative of the underlying performance of its business and that the "non-GAAP" or "adjusted" information provided is useful for investors to evaluate the comparability of the Company's operating results and its future outlook when reviewed in conjunction with the Company's GAAP financial statements. The non-GAAP measures are provided in addition to, and not as alternatives for, the Company's reported GAAP results.

The adjusted measures for the three months ended August 4, 2018 exclude the impact of asset impairment charges of \$3.0 million and certain professional services and legal fees and related costs of \$2.0 million. The asset impairment charges related primarily to the impairment of certain retail locations in Europe and North America resulting from under-performance and expected store closures. These items resulted in a combined \$3.9 million impact (after considering the related tax benefit of \$1.1 million), or an unfavorable \$0.05 per share impact during the three months ended August 4, 2018. Net earnings attributable to Guess?, Inc. were \$25.5 million and diluted earnings were \$0.31 per common share for the three months ended August 4, 2018. Excluding the impact of these items, adjusted net earnings attributable to Guess?, Inc. were \$29.5 million and adjusted diluted earnings were \$0.36 per common share for the three months ended August 4, 2018.

The adjusted measures for the six months ended August 4, 2018 exclude the impact of net gains on lease terminations of \$0.2 million, asset impairment charges of \$3.7 million and certain professional services and legal fees and related costs of \$5.8 million. The net gains on lease terminations related primarily to the early termination of certain lease agreements in North America. The asset impairment charges related primarily to the impairment of certain retail locations in Europe and North America resulting from under-performance and expected store closures. These items resulted in a combined \$7.3 million impact (after considering the related tax benefit of \$2.1 million), or an unfavorable \$0.09 per share impact during the six months ended August 4, 2018. Net earnings attributable to Guess?, Inc. were \$4.3 million and diluted earnings were \$0.05 per common share for the six months ended August 4, 2018. Excluding the impact of these items, adjusted net earnings attributable to Guess?, Inc. were \$11.6 million and adjusted diluted earnings were \$0.14 per common share for the six months ended August 4, 2018.

The adjusted measures for the three and six months ended July 29, 2017 exclude the impact of asset impairment charges of \$1.2 million and \$4.0 million, respectively, related primarily to the impairment of certain retail locations in North America resulting from under-performance and expected store closures. During the three months ended July 29, 2017, asset impairment charges resulted in a \$0.8 million impact (after considering the related tax benefit of \$0.4 million), or an unfavorable \$0.01 per share impact. Net earnings attributable to Guess?, Inc. were \$15.2 million and diluted earnings were \$0.18 per share for the three months ended July 29, 2017. Excluding the impact of the asset impairment charges and the related tax impact, adjusted net earnings attributable to Guess?, Inc. were \$16.1 million and adjusted diluted earnings were \$0.19 per common share for the three months ended July 29, 2017. During the six months ended July 29, 2017, asset impairment charges resulted in a \$2.8 million impact

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(after considering the related tax benefit of \$1.2 million), or an unfavorable \$0.04 per share impact. Net loss attributable to Guess?, Inc. was \$6.1 million and diluted loss was \$0.08 per share for the six months ended July 29, 2017. Excluding the impact of the asset impairment charges and the related tax impact, adjusted net loss attributable to Guess?, Inc. was \$3.3 million and adjusted diluted loss was \$0.04 per common share for the six months ended July 29, 2017.

Our discussion and analysis herein also includes certain constant currency financial information. Foreign currency exchange rate fluctuations affect the amount reported from translating the Company's foreign revenue, expenses and balance sheet amounts into U.S. dollars. These rate fluctuations can have a significant effect on reported operating results under GAAP. The Company provides constant currency information to enhance the visibility of underlying business trends, excluding the effects of changes in foreign currency translation rates. To calculate net revenue, comparable sales and earnings (loss) from operations on a constant currency basis, operating results for the current-year period are translated into U.S. dollars at the average exchange rates in effect during the comparable period of the prior year. To calculate balance sheet amounts on a constant currency basis, the current period balance sheet amount is translated into U.S. dollars at the exchange rate in effect at the comparable prior-year period end. The constant currency calculations do not adjust for the impact of revaluing specific transactions denominated in a currency that is different to the functional currency of that entity when exchange rates fluctuate. The constant currency information presented may not be comparable to similarly titled measures reported by other companies.

In calculating the estimated impact of currency fluctuations (including translational and transactional impacts) on other measures such as earnings (loss) per share, the Company estimates gross margin (including the impact of foreign exchange currency contracts designated as cash flow hedges for anticipated merchandise purchases) and expenses using the appropriate prior-year rates, translates the estimated foreign earnings (loss) at the comparable prior-year rates and excludes the year-over-year earnings impact of gains or losses arising from balance sheet remeasurement and foreign exchange currency contracts not designated as cash flow hedges for merchandise purchases.

Liquidity and Capital Resources

We need liquidity globally primarily to fund our working capital, occupancy costs, expansion plans, remodeling and rationalization of our retail stores, shop-in-shop programs, concessions, systems, infrastructure, other existing operations, international growth and potential acquisitions and investments. In addition, in the U.S. we need liquidity to fund share repurchases and payment of dividends to our stockholders. Generally, our working capital needs are highest during the late summer and fall as our inventories increase before the holiday selling period. During the six months ended August 4, 2018, the Company relied primarily on trade credit, available cash, real estate and other operating leases, capital leases, proceeds from short-term lines of credit and internally generated funds to finance our operations, payment of dividends, share repurchases and expansion. The Company anticipates that we will be able to satisfy our ongoing cash requirements during the next twelve months for working capital, capital expenditures, payments on our debt, capital leases and operating leases as well as lease termination payments, potential acquisitions and investments, share repurchases and dividend payments to stockholders, primarily with cash flow from operations and existing cash balances as supplemented by borrowings under our existing Credit Facility in the U.S. and Canada as well as bank facilities in Europe as needed. Such facilities are described further below under “—Borrowings and Capital Lease Obligations.”

In December 2017, the U.S. government enacted the Tax Reform, which significantly changed the U.S. corporate income tax laws, including moving from a global taxation regime to a territorial regime and lowering the future U.S. federal tax rate from 35% to 21%. The Company is also required to pay a transition tax on all historical earnings of foreign subsidiaries that have not been repatriated to the U.S. The income tax payable related to the transition tax is due over an eight-year period beginning in calendar 2018. The Company included \$0.4 million and \$17.7 million related to the transition tax in accrued expenses and other long-term liabilities in its condensed consolidated balance sheets as of August 4, 2018, respectively. The Company included \$1.9 million and \$17.7 million related to the transition tax in accrued expenses and other long-term liabilities in its condensed consolidated balance sheets as of February 3, 2018, respectively. The Company has provided for tax liabilities





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on amounts that are estimated to be repatriated from foreign operations as a result of the Tax Reform. We have not provided for other income taxes on undistributed foreign earnings expected to be reinvested outside the U.S. If in the future we decide to repatriate such earnings, we would incur other incremental taxes. Our current plans do not indicate a need to repatriate them to fund our U.S. cash requirements. As of August 4, 2018, the Company had cash and cash equivalents of \$219.1 million, of which approximately \$49.7 million was held in the U.S.

Excess cash and cash equivalents, which represent the majority of our outstanding cash and cash equivalents balance, are held primarily in overnight deposit and short-term time deposit accounts. Please see “—Important Factors Regarding Forward-Looking Statements” and “Part I, Item 1A. Risk Factors” contained in the Company’s most recent Annual Report on Form 10-K for the fiscal year ended February 3, 2018 for a discussion of risk factors which could reasonably be likely to result in a decrease of internally generated funds available to finance capital expenditures and working capital requirements.

The Company has presented below the cash flow performance comparison of the six months ended August 4, 2018, compared to the six months ended July 29, 2017.

**Operating Activities**

Net cash used in operating activities was \$21.7 million for the six months ended August 4, 2018, compared to \$9.7 million for the six months ended July 29, 2017, or a deterioration of \$12.0 million. This deterioration was driven primarily by changes in working capital due mainly to higher inventory resulting from retail expansion, partially offset by higher cash flows generated from net earnings for the six months ended August 4, 2018 compared to the same prior-year period.

**Investing Activities**

Net cash used in investing activities was \$53.2 million for the six months ended August 4, 2018, compared to \$39.5 million for the six months ended July 29, 2017. Net cash used in investing activities related primarily to capital expenditures incurred on retail expansion, investments in technology infrastructure and existing store remodeling programs. In addition, the cost of any business acquisitions, purchases of investments and other assets and the settlement of forward exchange currency contracts are also included in cash flows used in investing activities.

The increase in cash used in investing activities was driven primarily by higher spending on retail expansion during the six months ended August 4, 2018 compared to the same prior-year period. During the six months ended August 4, 2018, the Company opened 60 directly operated stores compared to 49 directly operated stores that were opened in the same prior-year period.

**Financing Activities**

Net cash used in financing activities was \$56.8 million for the six months ended August 4, 2018, compared to \$55.1 million for the six months ended July 29, 2017. Net cash used in financing activities related primarily to the payment of dividends and repurchases of shares of the Company’s common stock. In addition, payments related to capital lease obligations and borrowings and proceeds from issuance of common stock under our equity plan, capital contributions from noncontrolling interests and borrowings are also included in cash flows used in financing activities.

The increase in cash used in financing activities was driven primarily by higher payments for repurchases of shares of the Company’s common stock, partially offset by proceeds from issuance of common stock under our equity plan during the six months ended August 4, 2018 compared to the same prior-year period.

**Effect of Exchange Rates on Cash, Cash Equivalents and Restricted Cash**

During the six months ended August 4, 2018, changes in foreign currency translation rates decreased our reported cash, cash equivalents and restricted cash balance by \$16.6 million. This compares to an increase of \$24.4 million in cash, cash equivalents and restricted cash driven by changes in foreign currency translation rates during the six months ended July 29, 2017.

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## Working Capital

As of August 4, 2018, the Company had net working capital (including cash and cash equivalents) of \$583.1 million, compared to \$640.9 million at February 3, 2018 and \$670.8 million at July 29, 2017. The Company's primary working capital needs are for accounts receivable and inventory. Accounts receivable increased by \$49.8 million, or 21.3%, to \$283.4 million as of August 4, 2018, compared to \$233.6 million at July 29, 2017. The accounts receivable balance consists of trade receivables relating primarily to the Company's wholesale business in Europe and, to a lesser extent, to its wholesale businesses in the Americas and Asia, royalty receivables relating to its licensing operations, credit card and retail concession receivables related to its retail businesses and certain other receivables. On a constant currency basis, accounts receivable increased by \$55.4 million, or 23.7%, when compared to July 29, 2017. The increase was driven primarily by higher European wholesale shipments, partially offset by the favorable timing of collections during the six months ended August 4, 2018 compared to the same prior-year period. During the first quarter of fiscal 2019, the Company adopted a new revenue recognition standard on a modified retrospective basis which changed the presentation of allowances for wholesale sales returns and wholesale markdowns to be classified within accrued expenses rather than as a reduction to accounts receivable. Accordingly, the Company has included allowances of \$27.0 million and \$10.8 million related to wholesale sales returns and wholesale markdowns, respectively, in accrued expenses as of August 4, 2018. As of August 4, 2018, approximately 52% of our total net trade receivables and 62% of our European net trade receivables were subject to credit insurance coverage, certain bank guarantees or letters of credit for collection purposes. Our credit insurance coverage contains certain terms and conditions specifying deductibles and annual claim limits. Inventory increased by \$28.5 million, or 6.5%, to \$464.5 million as of August 4, 2018, compared to \$436.0 million at July 29, 2017. On a constant currency basis, inventory increased by \$37.7 million, or 8.6%, when compared to July 29, 2017, driven primarily by retail expansion in our international markets. The adoption of the new revenue recognition standard also impacted the presentation of the estimated cost associated with the allowance for sales returns to be included within other current assets rather than included in inventories. Accordingly, the Company has included \$11.6 million related to the estimated cost associated with the allowance for sales returns in other current assets as of August 4, 2018.

## Dividends

During the first quarter of fiscal 2008, the Company announced the initiation of a quarterly cash dividend of \$0.06 per share of the Company's common stock. Since that time, the Company has continued to pay a quarterly cash dividend, which has subsequently increased to \$0.225 per common share.

On August 29, 2018, the Company announced a regular quarterly cash dividend of \$0.225 per share on the Company's common stock. The cash dividend will be paid on September 28, 2018 to shareholders of record as of the close of business on September 12, 2018.

The payment of cash dividends in the future will be at the discretion of our Board of Directors and will be based upon a number of business, legal and other considerations, including our cash flow from operations, capital expenditures, debt service and covenant requirements, cash paid for income taxes, earnings, share repurchases, economic conditions and U.S. and global liquidity.

## Share Repurchases

On June 26, 2012, the Company's Board of Directors authorized a program to repurchase, from time-to-time and as market and business conditions warrant, up to \$500 million of the Company's common stock. Repurchases under the program may be made on the open market or in privately negotiated transactions, pursuant to Rule 10b5-1 trading plans or other available means. There is no minimum or maximum number of shares to be repurchased under the program, which may be discontinued at any time, without prior notice. During the six months ended August 4, 2018, the Company repurchased 1,118,808 shares under the program at an aggregate cost of \$17.6 million. The shares were repurchased during the three months ended May 5, 2018. During the six months ended August 4, 2018, the Company also paid an additional \$6.0 million for shares that were repurchased during the fourth quarter of fiscal 2018 but were settled during the first quarter of fiscal 2019. During the six months ended July 29, 2017, the Company repurchased 1,485,195 shares under the program at an aggregate cost of \$17.8 million.



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The shares were repurchased during the three months ended April 29, 2017. As of August 4, 2018, the Company had remaining authority under the program to purchase \$374.6 million of its common stock.

Capital Expenditures

Gross capital expenditures totaled \$46.0 million, before deducting lease incentives of \$4.9 million, for the six months ended August 4, 2018. This compares to gross capital expenditures of \$39.6 million, before deducting lease incentives of \$4.1 million for the six months ended July 29, 2017.

The Company's investments in capital for the full fiscal year 2019 are planned between \$90 million and \$95 million. The planned investments in capital are related primarily to retail and e-commerce expansion in Europe and Asia as well as continued investments in technology to support our long-term growth plans.

We will periodically evaluate strategic acquisitions and alliances and pursue those that we believe will support and contribute to our overall growth initiatives.

Borrowings and Capital Lease Obligations

Credit Facilities

On June 23, 2015, the Company entered into a five-year senior secured asset-based revolving credit facility with Bank of America, N.A. and the other lenders party thereto (the "Credit Facility"). The Credit Facility provides for a borrowing capacity in an amount up to \$150 million, including a Canadian sub-facility up to \$50 million, subject to a borrowing base. Based on applicable accounts receivable, inventory, eligible cash balances and relevant covenant restrictions as of August 4, 2018, the Company could have borrowed up to \$104 million under the Credit Facility. The Credit Facility has an option to expand the borrowing capacity by up to \$150 million subject to certain terms and conditions, including the willingness of existing or new lenders to assume such increased amount. The Credit Facility is available for direct borrowings and the issuance of letters of credit, subject to certain letters of credit sublimits, and may be used for working capital and other general corporate purposes.

All obligations under the Credit Facility are unconditionally guaranteed by the Company and the Company's existing and future domestic and Canadian subsidiaries, subject to certain exceptions, and are secured by a first priority lien on substantially all of the assets of the Company and such domestic and Canadian subsidiaries, as applicable.

Direct borrowings under the Credit Facility made by the Company and its domestic subsidiaries shall bear interest at the U.S. base rate plus an applicable margin (varying from 0.25% to 0.75%) or at LIBOR plus an applicable margin (varying from 1.25% to 1.75%). The U.S. base rate is based on the greater of (i) the U.S. prime rate, (ii) the federal funds rate, plus 0.5%, and (iii) LIBOR for a 30 day interest period, plus 1.0%. Direct borrowings under the Credit Facility made by the Company's Canadian subsidiaries shall bear interest at the Canadian prime rate plus an applicable margin (varying from 0.25% to 0.75%) or at the Canadian BA rate plus an applicable margin (varying from 1.25% to 1.75%). The Canadian prime rate is based on the greater of (i) the Canadian prime rate, (ii) the Bank of Canada overnight rate, plus 0.5%, and (iii) the Canadian BA rate for a one month interest period, plus 1.0%. The applicable margins are calculated quarterly and vary based on the average daily availability of the aggregate borrowing base. The Company is also obligated to pay certain commitment, letter of credit and other fees customary for a credit facility of this size and type. As of August 4, 2018, the Company had \$1.6 million in outstanding standby letters of credit, no outstanding documentary letters of credit and no outstanding borrowings under the Credit Facility.

The Credit Facility requires the Company to comply with a fixed charge coverage ratio on a trailing four-quarter basis if a default or an event of default occurs under the Credit Facility or generally if borrowings exceed 80% of the borrowing base. In addition, the Credit Facility contains customary covenants, including covenants that limit or restrict the Company and certain of its subsidiaries' ability to: incur liens, incur indebtedness, make investments, dispose of assets, make certain restricted payments, merge or consolidate and enter into certain transactions with affiliates. Upon the occurrence of an event of default under the Credit Facility, the lenders may cease making loans, terminate the Credit Facility and declare all amounts outstanding to be immediately due and payable. The Credit Facility specifies a number of events of default (some of which are subject to applicable

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grace or cure periods), including, among other things, non-payment defaults, covenant defaults, cross-defaults to other material indebtedness, bankruptcy and insolvency defaults and material judgment defaults. The Credit Facility allows for both secured and unsecured borrowings outside of the Credit Facility up to specified amounts.

The Company, through its European subsidiaries, maintains short-term uncommitted borrowing agreements, primarily for working capital purposes, with various banks in Europe. The majority of the borrowings under these agreements are secured by specific accounts receivable balances. Based on the applicable accounts receivable balances as of August 4, 2018, the Company could have borrowed or entered into documentary letters of credit totaling up to \$83.7 million under these agreements. As of August 4, 2018, the Company had no outstanding borrowings or outstanding documentary letters of credit under these agreements. The agreements are denominated primarily in euros and provide for annual interest rates ranging from 0.5% to 4.6%. The maturities of any short-term borrowings under these arrangements are generally linked to the credit terms of the underlying accounts receivable that secure the borrowings. With the exception of one facility for up to \$40.5 million that has a minimum net equity requirement, there are no other financial ratio covenants.

**Mortgage Debt**

On February 16, 2016, the Company entered into a ten-year \$21.5 million real estate secured loan (the "Mortgage Debt"). The Mortgage Debt is secured by the Company's U.S. distribution center based in Louisville, Kentucky and provides for monthly principal and interest payments based on a 25-year amortization schedule, with the remaining principal balance and any accrued and unpaid interest due at maturity. Outstanding principal balances under the Mortgage Debt bear interest at the one-month LIBOR rate plus 1.5%. As of August 4, 2018, outstanding borrowings under the Mortgage Debt, net of debt issuance costs of \$0.1 million, were \$20.0 million. At February 3, 2018, outstanding borrowings under the Mortgage Debt, net of debt issuance costs of \$0.1 million, were \$20.3 million.

The Mortgage Debt requires the Company to comply with a fixed charge coverage ratio on a trailing four-quarter basis if consolidated cash, cash equivalents and short term investment balances fall below certain levels. In addition, the Mortgage Debt contains customary covenants, including covenants that limit or restrict the Company's ability to incur liens on the mortgaged property and enter into certain contractual obligations. Upon the occurrence of an event of default under the Mortgage Debt, the lender may terminate the Mortgage Debt and declare all amounts outstanding to be immediately due and payable. The Mortgage Debt specifies a number of events of default (some of which are subject to applicable grace or cure periods), including, among other things, non-payment defaults, covenant defaults, cross-defaults to other material indebtedness, bankruptcy and insolvency defaults and material judgment defaults.

On February 16, 2016, the Company also entered into a separate interest rate swap agreement, designated as a cash flow hedge, that resulted in a swap fixed rate of approximately 3.06%. This interest rate swap agreement matures in January 2026 and converts the nature of the Mortgage Debt from LIBOR floating-rate debt to fixed-rate debt. The fair value of the interest rate swap asset for each of the periods ended August 4, 2018 and February 3, 2018 was approximately \$1.5 million.

**Capital Lease Obligations**

During fiscal 2018, the Company began the relocation of its European distribution center to the Netherlands. As a result, the Company entered into a capital lease of \$17.0 million for equipment used in the new facility. The capital lease primarily provides for monthly minimum lease payments through May 2027 with an effective interest rate of approximately 6%. As of August 4, 2018 and February 3, 2018, the capital lease obligation was \$15.4 million and \$17.3 million, respectively.

The Company also has smaller capital leases related primarily to computer hardware and software. As of August 4, 2018 and February 3, 2018, these capital lease obligations totaled \$2.3 million and \$1.3 million, respectively.

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Other

From time-to-time, the Company will obtain other financing in foreign countries for working capital to finance its local operations.

Supplemental Executive Retirement Plan

On August 23, 2005, the Board of Directors of the Company adopted a Supplemental Executive Retirement Plan (“SERP”) which became effective January 1, 2006. The SERP provides select employees who satisfy certain eligibility requirements with certain benefits upon retirement, termination of employment, death, disability or a change in control of the Company, in certain prescribed circumstances.

As a non-qualified pension plan, no dedicated funding of the SERP is required; however, the Company has made periodic payments into insurance policies held in a rabbi trust to fund the expected obligations arising under the non-qualified SERP. The amount of any future payments into the insurance policies, if any, may vary depending on investment performance of the trust. The cash surrender values of the insurance policies were \$64.3 million and \$64.5 million as of August 4, 2018 and February 3, 2018, respectively, and were included in other assets in the Company’s condensed consolidated balance sheets. As a result of changes in the value of the insurance policy investments, the Company recorded unrealized gains of \$1.7 million and \$0.7 million in other income during the three and six months ended August 4, 2018, respectively, and unrealized gains of \$1.9 million and \$3.8 million in other income during the three and six months ended July 29, 2017, respectively. The projected benefit obligation was \$54.9 million and \$54.8 million as of August 4, 2018 and February 3, 2018, respectively, and was included in accrued expenses and other long-term liabilities in the Company’s condensed consolidated balance sheets depending on the expected timing of payments. SERP benefit payments of \$0.4 million and \$0.8 million were made during the three and six months ended August 4, 2018, respectively. SERP benefit payments of \$0.4 million and \$0.8 million were made during the three and six months ended July 29, 2017, respectively.

Inflation

The Company does not believe that inflation trends in the U.S. and internationally over the last three years have had a significant effect on net revenue or profitability.

Seasonality

The Company’s business is impacted by the general seasonal trends characteristic of the apparel and retail industries. The retail operations in the Americas and Europe are generally stronger during the second half of the fiscal year, and the wholesale operations in the Americas generally experience stronger performance from July through November. The European wholesale businesses operate with two primary selling seasons: the Spring/Summer season, which ships from November to April and the Fall/Winter season, which ships from May to October. The Company may take advantage of early-season demand and potential reorders in its European wholesale business by offering a pre-collection assortment which ships at the beginning of each season. Customers retain the ability to request early shipment of backlog orders or delay shipment of orders depending on their needs.

Wholesale Backlog

We generally receive orders for fashion apparel three to six months prior to the time the products are delivered to our customers’ stores. The backlog of wholesale orders at any given time is affected by various factors, including seasonality, cancellations, the scheduling of market weeks, the timing of the receipt of orders and the timing of the shipment of orders and may include orders for multiple seasons. Accordingly, a comparison of backlogs of wholesale orders from period-to-period is not necessarily meaningful and may not be indicative of eventual actual shipments.

U.S. and Canada Backlog. Our U.S. and Canadian wholesale backlog as of September 5, 2018, consisting primarily of orders for fashion apparel, was \$50.1 million in constant currency, compared to \$36.9 million at September 6, 2017, an increase of 35.8%.

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Europe Backlog. As of September 2, 2018, the European wholesale backlog was €228.5 million, compared to €221.9 million at September 3, 2017, an increase of 3.0%. The backlog as of September 2, 2018 is comprised of sales orders for the Fall/Winter 2018 and Spring/Summer 2019 seasons.

Application of Critical Accounting Policies

Our critical accounting policies reflecting our estimates and judgments are described in “Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations,” in our Annual Report on Form 10-K for the year ended February 3, 2018 filed with the SEC on March 29, 2018. There have been no significant changes to our critical accounting policies during the six months ended August 4, 2018.

Recently Issued Accounting Guidance

In February 2016, the Financial Accounting Standards Board (“FASB”) issued a comprehensive new lease standard which will supersede previous lease guidance. The standard requires a lessee to recognize assets and liabilities related to long-term leases that were classified as operating leases under previous guidance in its balance sheet. An asset would be recognized related to the right to use the underlying asset and a liability would be recognized related to the obligation to make lease payments over the term of the lease. The standard also requires expanded disclosures surrounding leases. The standard (including clarification guidance issued during fiscal 2019) is effective for fiscal periods beginning after December 15, 2018, which will be the Company’s first quarter of fiscal 2020, with early adoption permitted. The Company has completed the design phase of its selected lease management system and is in the process of completing its inventory of its lease contracts as well as implementing processes and controls to enable the preparation of the required financial information for this standard. The Company will apply this guidance retrospectively at the beginning of the period of adoption through a cumulative-effect adjustment to retained earnings and expects that this guidance will result in material increases in assets and liabilities in its consolidated balance sheet as well as enhanced disclosures.

In June 2016, the FASB issued authoritative guidance related to the measurement of credit losses on financial instruments. This guidance is effective for fiscal years beginning after December 15, 2019, which will be the Company’s first quarter of fiscal 2021. Early adoption is permitted for fiscal periods beginning after December 15, 2018, which will be the Company’s first quarter of fiscal 2020. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements and related disclosures.

In January 2017, the FASB issued authoritative guidance to simplify the testing for goodwill impairment by removing step two from the goodwill testing. Under current guidance, if the fair value of a reporting unit is lower than its carrying amount (step one), an entity would calculate an impairment charge by comparing the implied fair value of goodwill with its carrying amount (step two). The implied fair value of goodwill was calculated by deducting the fair value of the assets and liabilities of the respective reporting unit from the reporting unit’s fair value as determined under step one. This guidance instead provides that an impairment charge should be recognized based on the difference between a reporting unit’s fair value and its carrying value. This guidance also does not require a qualitative test to be performed on reporting units with zero or negative carrying amounts. However, entities need to disclose any reporting units with zero or negative carrying amounts that have goodwill and the amount of goodwill allocated to each. This guidance is effective for fiscal years beginning after December 15, 2019, which will be the Company’s first quarter of fiscal 2021, with early adoption permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements or related disclosures.

In August 2017, the FASB issued authoritative guidance to better align the results of hedge accounting with an entity’s risk management activities. This guidance updates the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results in the financial statements. This guidance is effective for fiscal years beginning after December 15, 2018, which will be the Company’s first quarter of fiscal 2020, and requires a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption, with early adoption permitted. The updated presentation and disclosure guidance is required only on a prospective basis. The adoption of this guidance is not expected to have a material impact on the Company’s consolidated financial statements or related disclosures.





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In August 2018, the FASB issued authoritative guidance to modify the disclosure requirements on fair value measurements in ASC 820, Fair Value Measurement. This guidance is effective for fiscal years beginning after December 15, 2019, which will be the Company's first quarter of fiscal 2021, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its related disclosures.

In August 2018, the FASB issued authoritative guidance to modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This guidance is effective for fiscal years beginning after December 15, 2020, which will be the Company's first quarter of fiscal 2022, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its related disclosures.

In August 2018, the FASB issued authoritative guidance to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The guidance provides criteria for determining which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The capitalized implementation costs are required to be expensed over the term of the hosting arrangement. The guidance also clarifies the presentation requirements for reporting such costs in the entity's financial statements. This guidance is effective for fiscal years beginning after December 15, 2019, which will be the Company's first quarter of fiscal 2021, with early adoption permitted. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements and related disclosures.

### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk.

#### Exchange Rate Risk

More than half of product sales and licensing revenue recorded for the six months ended August 4, 2018 were denominated in currencies other than the U.S. dollar. The Company's primary exchange rate risk relates to operations in Europe, Canada, South Korea, China and Mexico. Changes in currencies affect our earnings in various ways. For further discussion on currency-related risk, please refer to our risk factors under "Part I, Item 1A. Risk Factors" contained in the Company's most recent Annual Report on Form 10-K for the fiscal year ended February 3, 2018.

#### Foreign Currency Translation Adjustment

The local selling currency is typically the functional currency for all of the Company's significant international operations. In accordance with authoritative guidance, assets and liabilities of the Company's foreign operations are translated from foreign currencies into U.S. dollars at period-end rates, while income and expenses are translated at the weighted average exchange rates for the period. The related translation adjustments are reflected as a foreign currency translation adjustment in accumulated other comprehensive income (loss) within stockholders' equity. In addition, the Company records foreign currency translation adjustments related to its noncontrolling interests within stockholders' equity. Accordingly, our reported other comprehensive income (loss) could be unfavorably impacted if the U.S. dollar strengthens, particularly against the British pound, Canadian dollar, Chinese yuan, euro, Japanese yen, Korean won, Mexican peso and Russian rouble. Alternatively, if the U.S. dollar weakens relative to those currencies, our reported other comprehensive income (loss) could be favorably impacted. Our foreign currency translation adjustments recorded in other comprehensive income (loss) are significantly impacted by net assets denominated in euros.

Periodically, the Company may also use foreign exchange currency contracts to hedge the translation and economic exposures related to its net investments in certain of its international subsidiaries (see below). Changes in the fair values of these foreign exchange currency contracts, designated as net investment hedges, are recorded in foreign currency translation adjustment as a component of accumulated other comprehensive income (loss) within stockholders' equity.

During the six months ended August 4, 2018, the total foreign currency translation adjustment decreased stockholders' equity by \$47.5 million, driven primarily by the weakening of the U.S. dollar against the euro.

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## Foreign Currency Transaction Gains and Losses

Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency, including gains and losses on foreign exchange currency contracts (see below), are included in the condensed consolidated statements of income (loss). Net foreign currency transaction losses included in the determination of net earnings (loss) were \$4.8 million and \$2.5 million for the six months ended August 4, 2018 and July 29, 2017, respectively.

## Foreign Exchange Currency Contracts

The Company operates in foreign countries, which exposes it to market risk associated with foreign currency exchange rate fluctuations. Various transactions that occur primarily in Europe, Canada, South Korea, China and Mexico are denominated in U.S. dollars, British pounds and Russian roubles and thus are exposed to earnings risk as a result of exchange rate fluctuations when converted to their functional currencies. These types of transactions include U.S. dollar denominated purchases of merchandise and U.S. dollar and British pound denominated intercompany liabilities. In addition, certain operating expenses, tax liabilities and pension-related liabilities are denominated in Swiss francs and are exposed to earnings risk as a result of exchange rate fluctuations when converted to the functional currency. The Company is also subject to certain translation and economic exposures related to its net investment in certain of its international subsidiaries. The Company enters into derivative financial instruments to offset some, but not all, of its exchange risk. In addition, some of the derivative contracts in place will create volatility during the fiscal year as they are marked-to-market according to the accounting rules and may result in revaluation gains or losses in different periods from when the currency impact on the underlying transactions are realized.

## Foreign Exchange Currency Contracts Designated as Cash Flow Hedges

During the six months ended August 4, 2018, the Company purchased U.S. dollar forward contracts in Europe totaling US\$21.6 million that were designated as cash flow hedges. As of August 4, 2018, the Company had forward contracts outstanding for its European and Canadian operations of US\$103.7 million and US\$17.4 million, respectively, to hedge forecasted merchandise purchases, which are expected to mature over the next 12 months. The Company's foreign exchange currency contracts are recorded in its condensed consolidated balance sheet at fair value based on quoted market rates. Changes in the fair value of the U.S. dollar forward contracts, designated as cash flow hedges for forecasted merchandise purchases, are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are recognized in cost of product sales in the period that approximates the time the hedged merchandise inventory is sold. Changes in the fair value of the U.S. dollar forward contracts, designated as cash flow hedges for forecasted intercompany royalties, are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are recognized in other income (expense) in the period in which the royalty expense is incurred.

As of August 4, 2018, accumulated other comprehensive income (loss) related to foreign exchange currency contracts included a net unrealized loss of approximately \$1.3 million, net of tax, of which \$2.5 million will be recognized in cost of product sales over the following 12 months, at the then current values on a pre-tax basis, which can be different than the current quarter-end values. As of August 4, 2018, the net unrealized gain of the remaining open forward contracts recorded in the Company's condensed consolidated balance sheet was approximately \$3.7 million. At February 3, 2018, the Company had forward contracts outstanding for its European and Canadian operations of US\$145.8 million and US\$38.7 million, respectively, that were designated as cash flow hedges. At February 3, 2018, the net unrealized loss of these open forward contracts recorded in the Company's condensed consolidated balance sheet was approximately \$13.7 million.

## Foreign Exchange Currency Contracts Not Designated as Hedging Instruments

The Company also has foreign exchange currency contracts that are not designated as hedging instruments for accounting purposes. Changes in fair value of foreign exchange currency contracts not designated as hedging instruments are reported in net earnings (loss) as part of other income (expense). For the six months ended August 4, 2018, the Company recorded a net gain of \$5.9 million for its euro and Canadian dollar foreign exchange

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currency contracts not designated as hedges, which has been included in other income. As of August 4, 2018, the Company had euro foreign exchange currency contracts to purchase US\$38.0 million expected to mature over the next nine months and Canadian dollar foreign exchange currency contracts to purchase US\$7.7 million expected to mature over the next five months. As of August 4, 2018, the net unrealized gain of these open forward contracts recorded in the Company's condensed consolidated balance sheet was approximately \$1.2 million.

At February 3, 2018, the Company had euro foreign exchange currency contracts to purchase US\$68.2 million and Canadian dollar foreign exchange currency contracts to purchase US\$17.6 million. At February 3, 2018, the net unrealized loss of these open forward contracts recorded in the Company's condensed consolidated balance sheet was approximately \$4.3 million.

**Sensitivity Analysis**

As of August 4, 2018, a sensitivity analysis of changes in foreign currencies when measured against the U.S. dollar indicates that, if the U.S. dollar had uniformly weakened by 10% against all of the U.S. dollar denominated foreign exchange derivatives totaling US\$166.7 million, the fair value of the instruments would have decreased by \$18.5 million. Conversely, if the U.S. dollar uniformly strengthened by 10% against all of the U.S. dollar denominated foreign exchange derivatives, the fair value of these instruments would have increased by \$15.2 million. Any resulting changes in the fair value of the hedged instruments may be partially offset by changes in the fair value of certain balance sheet positions (primarily U.S. dollar denominated liabilities in our foreign operations) impacted by the change in the foreign currency rate. The ability to reduce the exposure of currencies on earnings depends on the magnitude of the derivatives compared to the balance sheet positions during each reporting cycle.

**Interest Rate Risk**

The Company is exposed to interest rate risk on its floating-rate debt. The Company has entered into interest rate swap agreements to effectively convert its floating-rate debt to a fixed-rate basis. The principal objective of these contracts is to eliminate or reduce the variability of the cash flows in interest payments associated with the Company's floating-rate debt, thus reducing the impact of interest rate changes on future interest payment cash flows. The Company has elected to apply the hedge accounting rules in accordance with authoritative guidance for certain of these contracts.

**Interest Rate Swap Agreement Designated as Cash Flow Hedge**

During fiscal 2017, the Company entered into an interest rate swap agreement with a notional amount of \$21.5 million, designated as a cash flow hedge, to hedge the variability of cash flows in interest payments associated with the Company's floating-rate debt. This interest rate swap agreement matures in January 2026 and converts the nature of the Company's real estate secured term loan from LIBOR floating-rate debt to fixed-rate debt, resulting in a swap fixed rate of approximately 3.06%. The fair value of the interest rate swap agreement is based upon inputs corroborated by observable market data. Changes in the fair value of the interest rate swap agreement, designated as a cash flow hedge to hedge the variability of cash flows in interest payments associated with the Company's floating-rate debt, are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are amortized to interest expense over the term of the related debt.

As of August 4, 2018, accumulated other comprehensive income (loss) related to the interest rate swap agreement included a net unrealized gain of approximately \$1.2 million, net of tax, which will be recognized in interest expense after the following 12 months, at the then current values on a pre-tax basis, which can be different than the current quarter-end values. As of August 4, 2018 and February 3, 2018, the net unrealized gain of the interest rate swap recorded in the Company's condensed consolidated balance sheet was approximately \$1.5 million.

**Sensitivity Analysis**

As of August 4, 2018, approximately 93% of the Company's total indebtedness related to a real estate secured term loan and capital lease obligations. The real estate secured term loan is covered by a separate interest rate swap agreement with a swap fixed interest rate of approximately 3.06% that matures in January 2026. The interest

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rate swap agreement is designated as a cash flow hedge and converts the nature of the Company's real estate secured term loan from LIBOR floating-rate debt to fixed-rate debt. The capital lease obligations are based on fixed interest rates derived from the respective agreements.

The Company's remaining indebtedness is at variable rates of interest. Accordingly, changes in interest rates would impact the Company's results of operations in future periods. A 100 basis point increase in interest rates would have had an insignificant effect on interest expense for the six months ended August 4, 2018.

The fair value of the Company's debt instruments are based on the amount of future cash flows associated with each instrument discounted using the Company's incremental borrowing rate. As of August 4, 2018 and February 3, 2018, the carrying value of all financial instruments was not materially different from fair value, as the interest rates on the Company's debt approximated rates currently available to the Company.

#### ITEM 4. Controls and Procedures.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended.

Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the quarterly period covered by this report.

There was no change in our internal control over financial reporting during the second quarter of fiscal 2019 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings.

The Company is involved in legal proceedings, arising both in the ordinary course of business and otherwise, including the proceedings described below as well as various other claims and other matters incidental to the Company's business. Unless otherwise stated, the resolution of any particular proceeding is not currently expected to have a material adverse impact on the Company's financial position or results of operations. Even if such an impact could be material, we may not be able to estimate the reasonably possible loss or range of loss until developments in the proceedings have provided sufficient information to support an assessment.

On May 6, 2009, Gucci America, Inc. filed a complaint in the U.S. District Court for the Southern District of New York against Guess?, Inc. and certain third party licensees for the Company asserting, among other things, trademark and trade dress law violations and unfair competition. The complaint sought injunctive relief, compensatory damages, including treble damages, and certain other relief. Complaints similar to those in the above action were subsequently filed by Gucci entities against the Company and certain of its subsidiaries in the Court of Milan, Italy, the Intermediate People's Court of Nanjing, China and the Court of Paris, France. The three-week bench trial in the U.S. matter concluded on April 19, 2012, with the court issuing a preliminary ruling on May 21, 2012 and a final ruling on July 19, 2012. Although the plaintiff was seeking compensation in the U.S. matter in the form of damages of \$26 million and an accounting of profits of \$99 million, the final ruling provided for monetary damages of \$2.3 million against the Company and \$2.3 million against certain of its licensees. The court also granted narrow injunctions in favor of the plaintiff for certain of the claimed infringements. On August 20, 2012, the appeal period expired without any party having filed an appeal, rendering the judgment final. On May 2, 2013, the Court of Milan ruled in favor of the Company in the Milan, Italy matter. In the ruling, the Court rejected all of the plaintiff's claims and ordered the cancellation of three of the plaintiff's Italian and four of the plaintiff's European Community trademark registrations. On June 10, 2013, the plaintiff appealed the Court's ruling in the Milan matter. On September 15, 2014, the Court of Appeal of Milan affirmed the majority of the lower Court's ruling in favor of the Company, but overturned the lower Court's finding with respect to an unfair competition claim. That portion of the matter moved to a damages phase based on the ruling. On October 16, 2015, the plaintiff appealed the remainder of the Court of Appeal of Milan's ruling in favor of the Company to the Italian Supreme Court of Cassation. In the China matter, the Intermediate People's Court of Nanjing, China

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issued a ruling on November 8, 2013 granting an injunction in favor of the plaintiff for certain of the claimed infringements on handbags and small leather goods and awarding the plaintiff statutory damages in the amount of approximately \$80,000. The Company strongly disagreed with the Court's decision and appealed the ruling. On August 31, 2016, the Court of Appeal for the China matter issued a decision in favor of the Company, rejecting all of the plaintiff's claims. In March 2017, the plaintiff petitioned the China Supreme Court for a retrial of the matter. On January 30, 2015, the Court of Paris ruled in favor of the Company in the France matter, rejecting all of the plaintiff's claims and partially canceling two of the plaintiff's community trademark registrations and one of the plaintiff's international trademark registrations. On February 17, 2015, the plaintiff appealed the Court of Paris' ruling. In April 2018, the parties entered into an agreement to settle all pending worldwide intellectual property litigation and trademark office matters between the parties and their subsidiaries, including the previously active litigation matters in Italy, China and France. As part of the settlement, the parties agreed on the use of various design elements by each party on a go-forward basis. The settlement did not have a significant impact on the Company's financial results, and the terms of the settlement are not expected to have a negative impact on the Company's business operations going forward.

The Company has received customs tax assessment notices from the Italian Customs Agency ("ICA") regarding its customs tax audit of one of the Company's European subsidiaries for the period from July 2010 through December 2012. Such assessments totaled €9.8 million (\$11.4 million), including potential penalties and interest. The Company strongly disagrees with the positions that the ICA has taken and therefore filed appeals with the Milan First Degree Tax Court ("MFDTC"). In May 2015, the MFDTC issued a judgment in favor of the Company in relation to the first set of appeals (covering the period through September 2010) and canceled the related assessments totaling €1.7 million (\$2.0 million). In November 2015, the ICA notified the Company of its intent to appeal this first MFDTC judgment. During fiscal 2017, the Appeals Court ruled in favor of the Company and rejected the appeal by the ICA on the first MFDTC judgment. The ICA has appealed the majority of these to the Italian Supreme Court. During fiscal 2017, the MFDTC also issued judgments in favor of the Company in relation to the second through seventh set of appeals (covering the period from October 2010 through December 2012) and canceled the related assessments totaling €8.1 million (\$9.4 million). Subsequently, the Italian Customs Agency has appealed the majority of these favorable MFDTC judgments, as well as certain of the Appeals Court judgments. In April 2018, a different judge within the Appeals Court ruled in favor of the ICA with respect to a portion of the outstanding appeals (covering the period from October through December 2010) totaling €1.2 million (\$1.4 million). The Company believes that this recent Appeals Court ruling is incorrect and inconsistent with the prior rulings on similar matters by both the MFDTC and other judges within the Appeals Court, and plans to appeal the decision. In July 2018, a different section of the Appeals Court ruled in favor of the Company and rejected the appeals by the ICA with respect to a portion of the outstanding appeals (covering the periods from January through June 2012 and August through December 2012) totaling €3.0 million (\$3.4 million). There can be no assurances the Company will be successful in the remaining appeals. It also continues to be possible that the Company will receive similar or even larger assessments for periods subsequent to December 2012 or other claims or charges related to the matter in the future. Although the Company believes that it has a strong position and will continue to vigorously defend this matter, it is unable to predict with certainty whether or not these efforts will ultimately be successful or whether the outcome will have a material impact on the Company's financial position or results of operations.

On June 6, 2017, the European Commission notified the Company that it had initiated proceedings to investigate whether certain of the Company's practices and agreements concerning the distribution of apparel and accessories within the European Union breach European Union competition rules related to cross-border transactions, internet sales limitations and resale price restrictions. The Company has cooperated and plans to continue to cooperate with the European Commission, including through responses to requests for information and through changes to certain business practices and agreements, as appropriate. Depending on the outcome of the proceedings, a broad range of remedies is potentially available to the European Commission, including imposing a fine and/or injunctive relief prohibiting or restricting certain business practices. However, the Company does not currently believe that any changes to its business practices or agreements made in connection with these proceedings will have a material impact on its ongoing business operations within the European Union. As of



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November 6, 2017, the Company and the European Commission agreed to begin a settlement discussion process to determine if the parties can mutually agree on an outcome of the proceedings. Those discussions are still ongoing. To the extent the Company and the European Commission are able to reach an agreement, such agreement could occur as early as during fiscal 2019, although any resolution may be delayed due to the inherent unpredictability of the proceedings. Although it is currently not possible to assess the impact any settlement or other conclusion may have on our consolidated financial statements because the process is still ongoing, it is possible that the result could have a material adverse effect on our financial statements in the applicable reporting period.

## ITEM 1A. Risk Factors.

There have not been any material changes from the Risk Factors as previously disclosed in our Annual Report on Form 10-K for the year ended February 3, 2018, filed with the SEC on March 29, 2018.

## ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Items (a) and (b) are not applicable.

## Item (c). Issuer Purchases of Equity Securities

| Period                         | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs |
|--------------------------------|----------------------------------|------------------------------|--|--|
| May 6, 2018 to June 2, 2018    |                                  |                              |  |  |
| Repurchase program (1)         | —                                | —                            | —  | \$ 374,636,677   |
| Employee transactions (2)      | —                                | —                            | —  |  |
| June 3, 2018 to July 7, 2018   |                                  |                              |  |  |
| Repurchase program (1)         | —                                | —                            | —  | \$ 374,636,677   |
| Employee transactions (2)      | —                                | —                            | —  |  |
| July 8, 2018 to August 4, 2018 |                                  |                              |  |  |
| Repurchase program (1)         | —                                | —                            | —  | \$ 374,636,677   |
| Employee transactions (2)      | 21,324                           | \$ 21.97                     | —  |  |
| Total                          |                                  |                              |  |  |
| Repurchase program (1)         | —                                | —                            | —  |  |
| Employee transactions (2)      | 21,324                           | \$ 21.97                     | —  |  |

On June 26, 2012, the Company's Board of Directors authorized a program to repurchase, from time-to-time and as market and business conditions warrant, up to \$500 million of the Company's common stock. Repurchases under (1) the program may be made on the open market or in privately negotiated transactions, pursuant to Rule 10b5-1 trading plans or other available means. There is no minimum or maximum number of shares to be repurchased under the program, which may be discontinued at any time, without prior notice.

Consists of shares surrendered to, or withheld by, the Company in satisfaction of employee tax withholding (2) obligations that occur upon vesting of restricted stock awards/units granted under the Company's 2004 Equity Incentive Plan, as amended.

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ITEM 6. Exhibits.

| Exhibit<br>Number | Description   |
|-------------------|---|
| <u>3.1.</u>       | <u>Restated Certificate of Incorporation of the Registrant (incorporated by reference from Amendment No. 3 to the Registrant's Registration Statement on Form S-1 (Registration No. 333-4419) filed July 30, 1996).</u> |
| <u>3.2.</u>       | <u>Third Amended and Restated Bylaws of the Registrant (incorporated by reference from the Registrant's Annual Report on Form 10-K for the year ended February 3, 2018).</u>  |
| <u>4.1.</u>       | <u>Specimen Stock Certificate (incorporated by reference from Amendment No. 3 to the Registrant's Registration Statement on Form S-1 (Registration No. 333-4419) filed July 30, 1996).</u>                              |
| *†10.1.           | <u>Restricted Stock Unit Agreement dated as of June 25, 2018 for Paul Marciano and Victor Herrero.</u>  |
| *†10.2.           | <u>Performance Share Award Agreement (total shareholder return) dated as of June 25, 2018 for Paul Marciano and Victor Herrero.</u>   |
| *†10.3.           | <u>Performance Share Award Agreement (revenue and earnings from operations) dated as of June 25, 2018 for Paul Marciano and Victor Herrero.</u>   |
| *†10.4.           | <u>Form of Performance Share Award Agreement.</u>   |
| †31.1.            | <u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>  |
| †31.2.            | <u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>  |
| †32.1.            | <u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| †32.2.            | <u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  |
| †101.INS          | XBRL Instance Document  |
| †101.SCHXBRL      | Taxonomy Extension Schema Document  |
| †101.CALXBRL      | Taxonomy Extension Calculation Linkbase Document  |
| †101.DEF XBRL     | Taxonomy Extension Definition Linkbase Document   |
| †101.LABXBRL      | Taxonomy Extension Label Linkbase Document  |
| †101.PREXBRL      | Taxonomy Extension Presentation Linkbase Document   |

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\*Management Contract or Compensatory Plan

† Filed herewith



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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.

Guess?, Inc.

Date: September 6, 2018 By: /s/ VICTOR HERRERO

Victor Herrero  
Chief Executive Officer

Date: September 6, 2018 By: /s/ SANDEEP REDDY

Sandeep Reddy  
Chief Financial Officer  
(Principal Financial Officer)