

DECKERS OUTDOOR CORP

Form 10-Q

February 07, 2019

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 December 31, 2018

Commission File Number: 001-36436

DECKERS OUTDOOR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware 95-3015862
(State of incorporation) (I.R.S. Employer Identification No.)

250 Coromar Drive, Goleta, California 93117
(Address of principal executive offices)

(805) 967-7611
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 ☐ 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
o No y

As of the close of business on February 1, 2019, the number of outstanding shares of the registrant's common stock, par value \$0.01 per share, was 29,130,988.

DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES

For the Three and Nine Months Ended December 31, 2018

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*Not applicable.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q for our third fiscal quarter ended December 31, 2018 (Quarterly Report), and the information and documents incorporated by reference within this Quarterly Report, contain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which statements are subject to considerable risks and uncertainties. These forward-looking statements are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all statements other than statements of historical fact contained in, or incorporated by reference into, this Quarterly Report. We have attempted to identify forward-looking statements by using words such as “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “predict,” “project,” “should,” “will,” or “would,” and similar expressions or the negative of these expressions. Specifically, the Quarterly Report, and the information and documents incorporated by reference in this Quarterly Report, contain forward-looking statements relating to, among other things:

- the results of and costs associated with our restructuring and operating profit improvement plans;
- our global business, growth, operating, investing, and financing strategies;
- our product offerings, distribution channels, and geographic mix;
- consumer preferences with respect to our brands and products;
- the purchasing trends impacting the buying patterns of wholesale customers and retail consumers;
- the impact of seasonality and weather on consumer behavior and our results of operations;
- expectations regarding and trends and strategies affecting our financial condition, operating results, capital expenditures, liquidity or cash flows;
- expectations relating to the expansion of Direct-to-Consumer capabilities;
- our plans to consolidate certain United States (US) distribution center operations;
- overall global economic trends, including foreign currency exchange rate fluctuations;
- reliability of overseas factory production and storage;
- availability and cost of raw materials;
- our strategies for managing our market risk exposure and the nature of such exposure;
- the value of goodwill and other intangible assets, and potential write-downs or impairment charges;
- changes impacting our tax liability and effective tax rates, including as a result of changes in tax laws, guidance or treaties, foreign income or loss, and the realization of net deferred tax assets;
- completed and expected repatriation of earnings of non-US subsidiaries and any related foreign withholding taxes, as well as other related tax impacts;
- potential impacts of our ongoing operational system upgrades;
- commitments and contingencies, including purchase obligations for product and raw materials, including sheepskin; and
- the impact of recent accounting pronouncements.

Forward-looking statements represent management's current expectations and predictions about trends affecting our business and industry, and are based on information available at the time such statements are made. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy or completeness. Forward-looking statements involve numerous known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from any future results, performance or achievements predicted, assumed or implied by the forward-looking statements. Some of the risks and uncertainties that may cause our actual results to materially differ from those expressed or implied by these forward-looking statements are described in Part II, Item 1A, "Risk Factors," and Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," within this Quarterly Report, as well as in our other filings with the Securities and Exchange Commission. You should read this Quarterly Report, including the information and documents incorporated by reference herein, in its entirety and with the understanding that our actual future results may be materially different from the results expressed or implied by

these forward-looking statements. Moreover, new risks and uncertainties emerge from time to time and it is not possible for management to predict all risks and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause our actual future results to be materially different from any results expressed or implied by any forward-looking statements. Except as required by applicable law or the listing rules of the New York Stock Exchange, we expressly disclaim any intent or obligation to update any forward-looking statements. We qualify all of our forward-looking statements with these cautionary statements.

PART I. FINANCIAL INFORMATION

References to "Deckers," "we," "our," "us," or the "Company" refer to Deckers Outdoor Corporation, together with its consolidated subsidiaries. UGG® (UGG), Koolaburra® by UGG (Koolaburra), HOKA ONE ONE® (HOKA), Teva® (Teva), Sanuk® (Sanuk) and UGGpure™ (UGGpure) are some of the Company's trademarks. Other trademarks or trade names appearing elsewhere within this Quarterly Report are the property of their respective owners. Solely for convenience, the trademarks and trade names herein are referred to without the ® and™ symbols, but such references should not be construed as an indication that their respective owners will not assert, to the fullest extent under applicable law, their rights thereto.

Unless otherwise indicated, all dollar amounts herein are expressed in thousands, except per share or share data.

ITEM 1. FINANCIAL STATEMENTS

DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(dollar and share data amounts in thousands, except par value)

	December 31, 2018 (UNAUDITED)	March 31, 2018
ASSETS		
Current assets		
Cash and cash equivalents	\$ 515,938	\$429,970
Trade accounts receivable, net of allowances (\$21,705 and \$33,462 as of December 31, 2018 and March 31, 2018, respectively)	278,962	143,704
Inventories, net of reserves (\$10,342 and \$9,020 as of December 31, 2018 and March 31, 2018, respectively)	342,043	299,602
Prepaid expenses	17,505	17,639
Other current assets	49,660	17,599
Income tax receivable	2,532	2,176
Total current assets	1,206,640	910,690
Property and equipment, net of accumulated depreciation (\$230,248 and \$210,763 as of December 31, 2018 and March 31, 2018, respectively)	215,560	220,162
Goodwill	13,990	13,990
Other intangible assets, net of accumulated amortization (\$70,010 and \$66,065 as of December 31, 2018 and March 31, 2018, respectively)	52,924	57,850
Deferred tax assets, net	32,773	38,381
Other assets	20,564	23,306
Total assets	\$ 1,542,451	\$ 1,264,379
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Short-term borrowings	\$ 600	\$578
Trade accounts payable	228,434	93,939
Accrued payroll	42,107	55,695
Other accrued expenses	73,240	24,446
Income taxes payable	37,752	11,006
Value added tax payable	12,254	3,502
Total current liabilities	394,387	189,166
Mortgage payable	31,056	31,504
Income tax liability	59,016	64,735
Deferred rent obligations	21,360	22,499
Other long-term liabilities	18,751	15,696
Total long-term liabilities	130,183	134,434
Commitments and contingencies		
Stockholders' equity		
Common stock (\$0.01 par value; 125,000 shares authorized; shares issued and outstanding of 29,128 and 30,447 as of December 31, 2018 and March 31, 2018, respectively)	291	304
Additional paid-in capital	174,821	167,587

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Retained earnings	865,297	785,871
Accumulated other comprehensive loss	(22,528) (12,983)
Total stockholders' equity	1,017,881	940,779
Total liabilities and stockholders' equity	\$ 1,542,451	\$1,264,379

See accompanying notes to the condensed consolidated financial statements.

DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(dollar and share data amounts in thousands, except per share data)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2018	2017	2018	2017
Net sales	\$873,800	\$810,478	\$1,626,307	\$1,502,655
Cost of sales	403,707	387,007	789,362	763,442
Gross profit	470,093	423,471	836,945	739,213
Selling, general and administrative expenses	225,375	230,280	541,229	534,923
Income from operations	244,718	193,191	295,716	204,290
Interest income	(906	) (590	) (3,306	) (1,551
Interest expense	970	1,506	3,844	4,044
Other income, net	(13	) (778	) (213	) (990
Total other expense, net	51	138	325	1,503
Income before income taxes	244,667	193,053	295,391	202,787
Income tax expense	48,293	106,712	55,052	109,008
Net income	196,374	86,341	240,339	93,779
Other comprehensive (loss) income, net of tax				
Unrealized (loss) gain on cash flow hedges	(3,128	) 2,509	998	(2,174
Foreign currency translation gain (loss)	781	2,037	(10,543	) 6,555
Total other comprehensive (loss) income	(2,347	) 4,546	(9,545	) 4,381
Comprehensive income	\$194,027	\$90,887	\$230,794	\$98,160
Net income per share				
Basic	\$6.74	\$2.71	\$8.06	\$2.93
Diluted	\$6.68	\$2.69	\$7.99	\$2.91
Weighted-average common shares outstanding				
Basic	29,157	31,863	29,807	31,956
Diluted	29,397	32,041	30,063	32,186

See accompanying notes to the condensed consolidated financial statements.

DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (UNAUDITED)
(amounts in thousands)

	Common Stock		Additional	Retained	Accumulated	Total
	Shares	Amount	Paid-in Capital	Earnings	Other Comprehensive Loss	Stockholders' Equity
Balance, March 31, 2018	30,447	\$ 304	\$ 167,587	\$ 785,871	\$ (12,983)	\$ 940,779
Stock compensation expense	2	—	3,526	—	—	3,526
Shares issued upon vesting	6	—	—	—	—	—
Cumulative adjustment from adoption of new accounting guidance	—	—	—	720	—	720
Shares withheld for taxes	—	—	(328)	—	—	(328)
Repurchases of common stock	(86)	—	—	(9,999)	—	(9,999)
Net loss	—	—	—	(30,407)	—	(30,407)
Total other comprehensive loss	—	—	—	—	(2,140)	(2,140)
Balance, June 30, 2018	30,369	304	170,785	746,185	(15,123)	902,151
Stock compensation expense	2	—	3,926	—	—	3,926
Shares issued upon vesting	65	1	474	—	—	475
Cumulative adjustment from adoption of new accounting guidance	—	—	—	(252)	—	(252)
Shares withheld for taxes	—	—	(4,091)	—	—	(4,091)
Repurchases of common stock	(1,065)	(11)	—	(124,725)	—	(124,736)
Net income	—	—	—	74,372	—	74,372
Total other comprehensive loss	—	—	—	—	(5,058)	(5,058)
Balance, September 30, 2018	29,371	294	171,094	695,580	(20,181)	846,787
Stock compensation expense	2	—	4,037	—	—	4,037
Shares issued upon vesting	5	—	—	—	—	—
Shares withheld for taxes	—	—	(310)	—	—	(310)
Repurchases of common stock	(250)	(3)	—	(26,657)	—	(26,660)
Net income	—	—	—	196,374	—	196,374
Total other comprehensive loss	—	—	—	—	(2,347)	(2,347)
Balance, December 31, 2018	29,128	\$ 291	\$ 174,821	\$ 865,297	\$ (22,528)	\$ 1,017,881

See accompanying notes to the condensed consolidated financial statements.

DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(dollar amounts in thousands)

	Nine Months Ended December 31,	
	2018	2017
OPERATING ACTIVITIES		
Net income	\$240,339	\$93,779
Reconciliation of net income to cash provided by operating activities:		
Depreciation, amortization and accretion	33,547	36,655
Amortization on debt issuance costs	221	—
Loss on extinguishment of debt	447	—
Bad debt expense	1,971	3,649
Deferred tax expense	5,094	13,772
Stock-based compensation	11,400	10,485
Employee stock purchase plan	140	106
Loss on disposal of property and equipment	87	332
Impairment of intangible and other long-lived assets	180	1,900
Restructuring charges	295	1,667
Changes in operating assets and liabilities:		
Trade accounts receivable, net	(115,638)	(77,600)
Inventories, net	(54,373)	(97,458)
Prepaid expenses and other current assets	(19,808)	(9,075)
Income tax receivable	(357)	20,797
Other assets	3,493	(1,267)
Trade accounts payable	134,495	103,310
Accrued expenses	15,455	62,026
Income taxes payable	24,054	29,190
Long-term liabilities	(1,302)	60,828
Net cash provided by operating activities	279,740	253,096
INVESTING ACTIVITIES		
Purchases of property and equipment	(21,832)	(21,409)
Proceeds from sale of property and equipment, net	68	7
Net cash used in investing activities	(21,764)	(21,402)
FINANCING ACTIVITIES		
Proceeds from short-term borrowings	162,001	214,751
Repayments of short-term borrowings	(161,621)	(214,889)
Loan origination costs on short-term borrowings	(1,292)	—
Proceeds on issuance of stock for employee stock purchase plan	474	353
Cash paid for repurchase of common stock	(161,395)	(24,687)
Cash paid for shares withheld for taxes	(4,900)	(7,716)
Repayment of mortgage principal	(425)	(404)
Net cash used in financing activities	(167,158)	(32,592)
Effect of foreign currency exchange rates on cash	(4,850)	2,136
Net change in cash and cash equivalents	85,968	201,238
Cash and cash equivalents at beginning of period	429,970	291,764
Cash and cash equivalents at end of period	\$515,938	\$493,002

DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
 (dollar amounts in thousands)
 (continued)

	Nine Months Ended December 31,	
	2018	2017
SUPPLEMENTAL CASH FLOW DISCLOSURE		
Cash paid (refunded) during the period for:		
Income taxes, net of refunds and payments of \$3,674 and \$10,261, as of December 31, 2018 and 2017, respectively	\$29,646	\$(11,989)
Interest	3,158	3,156
Non-cash investing activity:		
Accrued for purchases of property and equipment	798	1,677
Accrued for asset retirement obligations	4,710	853

See accompanying notes to the condensed consolidated financial statements.

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DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended December 31, 2018 and 2017

(dollar amounts in thousands, except per share or share data)

Note 1. General

The Company

Deckers Outdoor Corporation is a global leader in designing, marketing, and distributing innovative footwear, apparel, and accessories developed for both everyday casual lifestyle use and high performance activities. As part of its Omni-Channel platform, the Company's proprietary brands are aligned across its Fashion Lifestyle group, including the UGG and Koolaburra brands, and Performance Lifestyle group, including the HOKA, Teva, and Sanuk brands.

The Company sells its products through domestic and international retailers, international distributors, and directly to its global consumers through its Direct-to-Consumer (DTC) business, which is comprised of its retail stores and E Commerce websites. Independent third party contractors manufacture all of the Company's products. A significant part of the Company's business is seasonal, requiring it to build inventory levels during certain quarters in its fiscal year to support higher selling seasons, which contributes to the variation in its results from quarter to quarter.

Basis of Presentation

The unaudited condensed consolidated financial statements and accompanying notes thereto (the condensed consolidated financial statements) as of December 31, 2018 and for the three and nine months ended December 31, 2018 and 2017 have been prepared in accordance with accounting principles generally accepted in the United States (US GAAP) for interim financial information pursuant to Rule 10-01 of Regulation S-X issued by the Securities and Exchange Commission (SEC). Accordingly, they do not include all the information and disclosures required by US GAAP for annual financial statements and accompanying notes thereto. The condensed consolidated balance sheet as of March 31, 2018 was derived from the Company's audited consolidated financial statements. In the opinion of management, the condensed consolidated financial statements include all adjustments consisting of all normal and recurring entries necessary to fairly present the results of interim periods presented, but are not necessarily indicative of results to be achieved for full fiscal years or other interim periods. The condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes thereto in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2018, filed with the SEC on May 30, 2018 (2018 Annual Report).

Consolidation. The condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries, and entities in which it maintains a controlling financial interest. All intercompany balances and transactions have been eliminated in consolidation.

Reclassifications. Certain reclassifications were made for prior periods presented to conform to the current period presentation.

Use of Estimates. The preparation of the Company's condensed consolidated financial statements is made in accordance with US GAAP, which requires management to make estimates and assumptions that affect the amounts reported in these condensed consolidated financial statements. Management bases these estimates and assumptions upon historical experience, existing and known circumstances, authoritative accounting pronouncements and other factors that management believes to be reasonable. Significant areas requiring the use of management estimates relate to inventory write-downs, trade accounts receivable allowances, sales returns liabilities, stock-based compensation,

impairment assessments, depreciation and amortization, income tax liabilities, uncertain tax positions and income taxes receivable, the fair value of financial instruments, and the fair values of assets and liabilities, including goodwill and other intangible assets. These estimates are based on information available as of the date of the condensed consolidated financial statements, and actual results could differ materially from the results assumed or implied based on these estimates.

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DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended December 31, 2018 and 2017

(dollar amounts in thousands, except per share or share data)

Reportable Operating Segments

The Company performs an annual assessment of the appropriateness of its reportable operating segments during the third quarter of its fiscal year. However, due to known circumstances arising during the three months ended June 30, 2018, management performed this assessment during the first quarter of the fiscal year ending March 31, 2019 (Q1 2019). These circumstances included quantitative factors, such as the actual and forecasted sales and operating income of the wholesale operations of the HOKA brand compared to the Company's other reportable operating segments, as well as qualitative factors such as the ongoing growth of, and the Company's increased investment in, the wholesale operations of the HOKA brand. As a result, beginning in Q1 2019, the Company added a sixth reportable operating segment to separately report the wholesale operations of the HOKA brand. The wholesale operations of the HOKA brand are no longer presented under the Other brands wholesale reportable operating segment. However, the DTC operations of the HOKA brand continue to be reported under the DTC reportable operating segment. Prior periods presented were reclassified to reflect this change.

The Company's six reportable operating segments now include the worldwide wholesale operations of the UGG brand, HOKA brand, Teva brand, Sanuk brand, and Other brands, as well as DTC. Information reported to the Chief Operating Decision Maker (CODM), who is the Company's Principal Executive Officer, is organized into these reportable operating segments and is consistent with how the CODM evaluates performance and allocates resources. Refer to Note 12, "Reportable Operating Segments," for further information on the Company's reportable operating segments.

Restructuring Plan

In February 2016, the Company announced the implementation of a multi-year restructuring plan which is designed to realign its brands across its Fashion Lifestyle and Performance Lifestyle groups, optimize the Company's retail store fleet, and consolidate its management and operations. In general, the intent of this restructuring plan is to streamline brand operations, reduce overhead costs, create operating efficiencies, and improve collaboration across brands.

In connection with the restructuring plan, the Company has closed 43 retail stores as of December 31, 2018, including conversions to partner retail stores, and consolidated its brand operations and corporate headquarters. Through December 31, 2018, the Company had incurred cumulative restructuring charges by applicable reportable operating segment as follows:

	Cumulative Restructuring Charges
UGG brand wholesale	\$ 2,238
Sanuk brand wholesale	3,068
Other brands wholesale	2,263
Direct-to-Consumer	23,454
Unallocated overhead costs	24,596
Total	\$ 55,619

During the nine months ended December 31, 2018 and 2017, the Company incurred \$295 and \$1,667 of restructuring charges, respectively, which were recorded in selling, general and administrative (SG&A) expenses in the condensed consolidated statements of comprehensive income. During the nine months ended December 31, 2018 and 2017, these

restructuring charges were recorded in SG&A expenses in the DTC reportable operating segment (\$295 and \$149, respectively) and unallocated overhead costs (\$1,518 for the nine months ended December 31, 2017). Of the cumulative restructuring charges incurred through December 31, 2018, \$3,277 remained accrued as of that date, with \$1,509 recorded in other accrued expenses and \$1,768 recorded between deferred rent obligations and other long-term liabilities, respectively, in the condensed consolidated balance sheets. The Company currently does not anticipate incurring material restructuring charges in future periods.

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DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended December 31, 2018 and 2017

(dollar amounts in thousands, except per share or share data)

The remaining accrued liabilities for cumulative restructuring charges incurred to date under the Company's restructuring plan are as follows:

	Lease Terminations	Other*	Total
Balance as of March 31, 2018	\$ 3,645	\$1,083	\$4,728
Additional charges	295	—	295
Paid in cash	(1,165)	(581)	(1,746)
Balance as of December 31, 2018	\$ 2,775	\$502	\$3,277

*Includes costs related to office consolidations and termination of contracts and services.

Refer to the section entitled "Recent Developments," in Part I, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," within this Quarterly Report for further information.

Recent Accounting Pronouncements

Recently Adopted. The Financial Accounting Standards Board (FASB) issued Accounting Standard Updates (ASUs) that have been adopted by the Company for its annual and interim reporting periods as stated below. The following is a summary of each standard and the impact on the Company:

Standard	Description	Impact on Adoption
		The Company early adopted this ASU on a prospective basis, beginning October 1, 2018.
ASU No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract	Aligns 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. Requires companies to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement.	The Company evaluated its business policies and processes around implementation costs incurred in a cloud computing arrangement (CCA) that is a service contract and made a change in its accounting policy. The Company historically recognized expenses for implementation costs associated with a CCA as incurred. Upon adoption, certain implementation costs associated with CCAs will be capitalized to prepaid expenses and amortized over the term of the service arrangement.
ASU No. 2016-15, Statement of Cash Flows, Classification	Eliminates the diversity in practice related to the classification of certain cash	Adoption of this ASU had an immaterial impact on the Company's condensed consolidated financial statements during the third quarter of the fiscal year ending March 31, 2019. This ASU was adopted by the Company on April 1, 2018. The Company evaluated

of Certain Cash Receipts and Cash Payments receipts and payments.

its business policies and processes around cash receipts and payments and determined that this ASU did not have a material impact on its condensed consolidated financial statements and related disclosures.

ASU No. 2016-16, Accounting for Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory Requires that the income tax impact of intra-entity sales and transfers of property, except for inventory, be recognized when the transfer occurs.

This ASU was adopted by the Company on April 1, 2018. The Company evaluated its business policies and processes around intra-entity transfers of assets, other than inventory, and determined that this ASU did not have a material impact on its condensed consolidated financial statements and related disclosures.

ASU No. 2017-09, Compensation - Stock Compensation: Scope of Modification Accounting Modification accounting is required to be applied for share-based payment awards immediately before the original award is modified unless the fair value, vesting conditions, and classification of the modified awards are the same as the fair value, vesting conditions and classification of the original award, respectively.

This ASU was adopted by the Company on April 1, 2018. The Company evaluated its business policies and processes around share-based payment modifications and determined that this ASU did not have a material impact on its condensed consolidated financial statements and related disclosures.

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DECKERS OUTDOOR CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the Three and Nine Months Ended December 31, 2018 and 2017

(dollar amounts in thousands, except per share or share data)

Standard	Description	Impact on Adoption
		The Company adopted this ASU (the new revenue standard) using the modified retrospective transition method, beginning April 1, 2018.
		Prior to adoption, the Company deferred recognition of revenue for certain wholesale and E-Commerce sales arrangements until the product was delivered. However, the Company elected the practical expedient allowed under the new revenue standard to define shipping and handling costs as a fulfillment service, not a performance obligation. Accordingly, the Company will now recognize revenue for these arrangements upon shipment of product, rather than delivery. As a result, on adoption of this ASU, the Company recorded a cumulative effect adjustment net after tax increase to opening retained earnings of approximately \$1,000 in its condensed consolidated balance sheets. This prospective change in accounting policy will impact comparatives to prior reported fiscal years as net sales and deferred revenue are recognized and recorded in the Company's condensed consolidated financial statements under legacy US GAAP.
ASU No. 2014-09, Revenue from Contracts with Customers (as amended by ASUs 2015-14, 2016-08, 2016-10, 2016-11, 2016-12, 2016-20, 2017-13, and 2017-14)	Requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers and replaces most existing revenue recognition guidance under US GAAP. The FASB issued additional guidance which clarifies how to apply the implementation guidance related to principal versus agent considerations, how to identify performance obligations, as well as licensing implementation guidance.	The Company historically recorded a trade accounts receivable allowance for sales returns (allowance for sales returns) related to its wholesale channel sales, and the cost of sales for the product-related inventory was recorded in inventories, net of reserves, in its condensed consolidated balance sheets. As of March 31, 2018, the Company recorded an allowance for sales returns for the wholesale channel of \$20,848 and product-related inventory for all channels of \$11,251 in its condensed consolidated balance sheets. As of June 30, 2018, and in connection with the adoption of the new revenue standard, the Company reclassified the allowance for sales returns for the wholesale channel of \$9,816 to other accrued expenses and the product-related inventory for all channels of \$4,819 to other current assets in its condensed consolidated balance sheets. For the DTC channel, the allowance for sales returns was recorded in other accrued expenses, which is consistent with the prior period presented. The comparative condensed consolidated financial statements have not been adjusted and continue to be reported under legacy US GAAP. Refer to Note 2, "Revenue Recognition," for expanded disclosures regarding this change in accounting policy and refer to Note 12, "Reportable Operating Segments," for the Company's disaggregation of revenue by distribution channel and region.

Not Yet Adopted. The FASB issued the following ASUs that have not yet been adopted by the Company. The following is a summary of each new ASU, the planned period of adoption and the expected impact on the Company on adoption:

Standard	Description	Planned Period of Adoption	Expected Impact on Adoption
ASU No. 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities (as amended by ASU 2018-16)	Seeks to improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities and to reduce the complexity of and simplify the application of hedge accounting. This ASU eliminates the requirement to separately measure and report hedge ineffectiveness.	Q1 FY 2020	The Company has completed an initial assessment of the effect that the adoption of this SEC update will have on its condensed consolidated financial statements and related disclosures, and will eliminate effectiveness testing for its derivative contracts designated as cash flow hedges; however, this change is not expected to have a material impact.

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Standard	Description	Planned Period of Adoption	Expected Impact on Adoption
ASU No. 2016-02, Leases (as amended by ASUs 2015-14, 2018-01, 2018-10, 2018-11, and 2018-20)	Requires a lessee to recognize a lease asset and lease liability in its consolidated balance sheets. A lessee should recognize a right-of-use (ROU) asset representing its right to use the underlying asset for the lease term, and a liability to make lease payments.	Q1 FY 2020	<p>The Company has completed an initial assessment of the effect that the adoption of this ASU will have on its condensed consolidated financial statements and related disclosures and expects a material impact. The result is expected to be a material increase in assets and liabilities due to the recognition of an ROU asset and corresponding lease liability, including for lease commitments that are currently classified as operating leases, such as retail stores, showrooms, offices, and distribution facilities. The classification and recognition of lease expense is not expected to materially change from legacy US GAAP. Further, the adoption of this ASU will result in expanded disclosures on existing and new lease commitments.</p> <p>The Company expects to adopt this ASU on a prospective basis and elect the "package of practical expedients" allowed with adoption of this ASU, which provides a number of transition options, including (1) reassessment of prior conclusions about lease identification, classification and initial direct costs is not required; (2) the ability to elect a short-term lease recognition exemption for current and new vehicle, IT and office equipment leases that qualify to be excluded from the recognized ROU asset and related liability; and (3) separation of lease and non-lease components is not required. The Company does not expect a significant change in its lease portfolio and business practices leading up to adoption of this ASU. Further, the Company has selected a software provider, has a project team in place and implementation is currently underway.</p>
ASU No. 2017-04, Goodwill and Other: Simplifying the Test for Goodwill Impairment	Requires annual and interim goodwill impairment tests be performed by comparing the fair value of a reporting unit with its carrying amount, effectively eliminating step two of the goodwill impairment test under legacy US GAAP. The amount by which the carrying amount exceeds the reporting	Q1 FY 2021	<p>The Company is evaluating the timing and effect that adoption of this ASU will have on its condensed consolidated financial statements and related disclosures.</p>

	unit's fair value should be recognized as an impairment charge.		
ASU No. 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments (as amended by ASU 2018-19)	Replaces the incurred loss impairment methodology in legacy US GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates.	Q1 FY 2021	The Company is evaluating the timing and effect that adoption of this ASU will have on its condensed consolidated financial statements and related disclosures.

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Note 2. Revenue Recognition

Nature of Performance Obligations

Revenue is recognized when a performance obligation is completed at a point in time and when the customer has obtained control. Control passes to the customer when they have the ability to direct the use of, and obtain substantially all the remaining benefits from, the goods transferred. The amount of revenue recognized is based on the transaction price, which represents the invoiced amount less known actual amounts or estimates of variable consideration. The Company recognizes revenue and measures the transaction price to be net of taxes, including sales taxes, use taxes, value-added taxes, and some types of excise taxes, collected from customers and remitted to governmental authorities. The Company presents revenue gross of fees and sales commissions. Sales commissions are expensed as incurred and are recorded in SG&A expenses in the condensed consolidated statements of comprehensive income. As a result of the short durations of the Company's customer contracts, which are typically effective for one year or less and have payment terms that are generally 30-60 days, these arrangements are not considered to have a significant financing component.

Wholesale and international distributor revenue is recognized when products are shipped, as well as when delivered, depending on the contract terms. E-Commerce revenue is recognized upon shipment and at the point of sale for retail store transactions. Shipping and handling costs paid to third-party shipping companies are recorded as cost of sales in the condensed consolidated statements of comprehensive income. Shipping and handling costs are a fulfillment service and, for certain wholesale and all E-Commerce transactions, revenue is recognized when the customer is deemed to obtain control upon the date of shipment.

Variable Consideration

Components of variable consideration include estimated discounts, markdowns or chargebacks, and sales returns. Estimates for variable consideration are based on the amounts earned, or estimates to be claimed as an adjustment to sales. Estimated variable consideration is included in the transaction price to the extent that it is probable that a significant reversal of the cumulative revenue recognized will not occur in a future period. Actual amounts of consideration provided to the customer may differ from the Company's estimates.

Allowance for Sales Discounts. The Company provides a trade accounts receivable allowance for term discounts for wholesale channel sales, which reflects a discount that customers may take, generally based on meeting certain order, shipment or prompt payment terms. The Company uses the amount of the discounts that are available to be taken against the period-end trade accounts receivable to estimate and record a corresponding reserve for sales discounts. Additions to the allowance are recorded against gross sales in the condensed consolidated statements of comprehensive income. This is consistent with the presentation of such amounts in the prior period. As of December 31, 2018 and March 31, 2018, the Company did not have a material trade accounts receivable allowance for sales discounts.

Allowance for Chargebacks. The Company provides a trade accounts receivable allowance for chargebacks from wholesale customers. When customers pay their invoices, they may take deductions against their invoices that can include chargebacks for price differences, markdowns, short shipments and other reasons. Therefore, the Company records an allowance for known and unknown circumstances based on historical trends related to the timing and amount of chargebacks taken against wholesale channel customer invoices. Additions to the allowance are recorded

against gross sales in the condensed consolidated statements of comprehensive income. This is consistent with the presentation of such amounts in the prior period. As of December 31, 2018, the Company recorded a trade accounts receivable allowance for chargebacks of \$16,064 compared to \$7,727 as of March 31, 2018 in the condensed consolidated balance sheets.

Contract Assets and Liabilities

Contract assets represent the Company's right to consideration subject to conditions other than the passage of time, such as additional performance obligations to be satisfied. Contract liabilities are performance obligations that

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the Company expects to satisfy or relieve within the next 12 months, advance consideration obtained prior to satisfying a performance obligation, or unconditional obligations to provide goods or services under non-cancellable contracts before the transfer of goods or services to the customer has occurred. Contract assets and liabilities are recorded in other current assets and other accrued expenses, respectively, in the condensed consolidated balance sheets.

Sales Returns. Reserves are recorded for anticipated future returns of goods shipped prior to the end of the reporting period. In general, the Company accepts returns for damaged or defective products for up to one year. The Company also has a policy whereby returns are accepted from DTC customers for up to 30 days from point of sale for cash or credit with a receipt. Amounts of these reserves are based on known and actual returns, historical returns, and any recent events that could result in a change from historical return rates. Sales returns are a contract asset for the right to recover product-related inventory and a contract liability for advance consideration obtained prior to satisfying a performance obligation. Changes to the sales return reserve are recorded against gross sales for the contract liability and cost of sales for the contract asset in the condensed consolidated statements of comprehensive income.

The following table provides activity during the nine months ended December 31, 2018 related to estimated sales returns for the Company's existing customer contracts for all channels:

	Contract Asset	Contract Liability
Balance as of March 31, 2018	\$ 11,251	\$ 23,156
Change in estimate of sales returns	29,653	104,009
Actual returns	(24,549)	(82,828)
Balance as of December 31, 2018	\$ 16,355	\$ 44,337

Deferred Revenue. Revenue is deferred for certain wholesale channel transactions as the contract terms indicate control transfers upon product delivery or sell-through. As of December 31, 2018 and March 31, 2018, the Company did not have a material contract liability for deferred revenue.

Gift Cards. The Company defers recognition of revenue from the sale of gift cards until the gift card is redeemed by the customer or the Company determines that the likelihood of redemption is remote. As of December 31, 2018 and March 31, 2018, the Company's contract liability for gift cards was \$3,309 and \$3,105, respectively, and is recorded in other accrued expenses in the condensed consolidated balance sheets.

Loyalty Programs. The Company has a customer loyalty program for the UGG brand in its DTC channel where customers earn rewards from qualifying purchases or activities. The Company defers recognition of revenue for unredeemed awards until the following occurs: (1) rewards are redeemed by the customer, (2) points or certificates expire, or (3) an estimate of the expected unused portion of points or certificates is applied, which is based on historical redemption patterns. As of December 31, 2018 and March 31, 2018, the Company's contract liability for loyalty programs was \$7,323 and \$5,477, respectively, and is recorded in other accrued expenses in the condensed consolidated balance sheets.

Note 3. Goodwill and Other Intangible Assets

Goodwill and Other Intangible Assets

The Company's goodwill and other intangible assets are recognized as follows:

	December 31, 2018	March 31, 2018
Goodwill		
UGG brand	\$ 6,101	\$ 6,101
HOKA brand	7,889	7,889
Total	13,990	13,990

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	December 31, 2018	March 31, 2018
Other intangible assets		
Indefinite-lived intangible assets		
Trademarks	15,454	15,454
Definite-lived intangible assets		
Trademarks	55,245	55,245
Other	52,235	53,216
Total gross carrying amount	107,480	108,461
Accumulated amortization	(70,010)	(66,065)
Net definite-lived intangible assets	37,470	42,396
Total	52,924	57,850
Total	\$ 66,914	\$ 71,840

Amortization Expense

Aggregate amortization expense for amortizable intangible assets during the nine months ended December 31, 2018 was \$4,817 compared to \$5,827 during the nine months ended December 31, 2017. A reconciliation of the changes in total other intangible assets in the condensed consolidated balance sheets is as follows:

Balance as of March 31, 2018	\$57,850
Amortization expense	(4,817)
Foreign currency exchange rate fluctuations, net	(109)
Balance as of December 31, 2018	\$52,924

Note 4. Fair Value Measurements

The fair values of the Company's cash and cash equivalents, net trade accounts receivable, prepaid expenses, income taxes receivable, other current assets, short-term borrowings, trade accounts payable, accrued payroll, other accrued expenses, income taxes payable, and value added tax payable approximate their carrying values due to the relatively short maturities of these assets and liabilities. The fair values of the Company's long-term liabilities do not significantly differ from their carrying values. The inputs used to measure fair value are prioritized into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Level 2: Observable inputs other than quoted prices in active markets for identical assets and liabilities.

Level 3: Unobservable inputs in which little or no market activity exists, therefore requiring the reporting entity to develop its own assumptions.

The assets and liabilities that are measured on a recurring basis at fair value as of the dates below are as follows:

	December 31, 2018	Measured Using Level 1	Level 2	Level 3
Non-qualified deferred compensation asset	\$ 6,569	\$6,569	\$ —	\$ —
Non-qualified deferred compensation liability	(4,802)	(4,802)	—	—
Designated Derivative Contracts asset	1,850	—	1,850	—

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Non-Designated Derivative Contracts asset	94	—	94	—
Non-Designated Derivative Contracts liability (5)	—	(5)	—

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