

SKECHERS USA INC  
Form 10-K  
February 29, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-K**

(Mark One)

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

**For the fiscal year ended December 31, 2007**

**OR**

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

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

**Commission File Number 001-14429**

**SKECHERS U.S.A., INC.**

*(Exact Name of Registrant as Specified in Its Charter)*

**Delaware**

*(State or Other Jurisdiction of Incorporation or  
Organization)*

**95-4376145**

*(I.R.S. Employer Identification No.)*

**228 Manhattan Beach Blvd., Manhattan Beach,  
California**

*(Address of Principal Executive Offices)*

**90266**

*(Zip Code)*

Registrant's telephone number, including area code: **(310) 318-3100**

**Securities registered pursuant to Section 12(b) of the Act:**

**Title of Each Class**

**Name of Each Exchange on  
Which Registered**

Class A Common Stock, \$0.001 par value

New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act:**

None

(Title of Class)

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☒ No ☐

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐  
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

As of June 30, 2007, the aggregate market value of the voting and non-voting Class A and Class B Common Stock held by non-affiliates of the Registrant was approximately \$957 million based upon the closing price of \$29.20 of the Class A Common Stock on the New York Stock Exchange on such date.

The number of shares of Class A Common Stock outstanding as of February 15, 2008: 33,009,788.

The number of shares of Class B Common Stock outstanding as of February 15, 2008: 12,851,789.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Definitive Proxy Statement issued in connection with the 2008 Annual Meeting of the Stockholders of the Registrant are incorporated by reference into Part III.

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**SPECIAL NOTE ON FORWARD LOOKING STATEMENTS**

This annual report on Form 10-K contains forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, including statements with regards to future revenue, projected 2008 results, earnings, spending, margins, cash flow, orders, expected timing of shipment of products, inventory levels, future growth or success in specific countries, categories or market sectors, continued or expected distribution to specific retailers, liquidity, capital resources and market risk, strategies and objectives. Forward-looking statements include, without limitation, any statement that may predict, forecast, indicate or simply state future results, performance or achievements of our company, and can be identified by the use of forward looking language such as believe, anticipate, expect, estimate, intend, plan, project, will be, will continue, may, might, or any variations of such words with similar meanings. Any such statements are subject to risks and uncertainties that could cause actual results to differ materially from those which are management's current expectations or forecasts. Such information is subject to the risk that such expectations or forecasts, or the assumptions underlying such expectations or forecasts, become inaccurate.

Risk factors include but are not limited to the following: international, national and local general economic, political and market conditions; intense competition among sellers of footwear for consumers; changes in fashion trends and consumer demands; popularity of particular designs and categories of products; the level of sales during the spring, back-to-school and holiday selling seasons; the ability to anticipate, identify, interpret or forecast changes in fashion trends, consumer demand for our products and the various market factors described above; the ability of our company to maintain its brand image; the ability to sustain, manage and forecast our company's growth and inventories; the ability to secure and protect trademarks, patents and other intellectual property; the loss of any significant customers, decreased demand by industry retailers and cancellation of order commitments; potential disruptions in manufacturing related to overseas sourcing and concentration of production in China, including, without limitation, difficulties associated with political instability in China, increases in labor or raw material costs, the occurrence of prolonged adverse weather conditions, a natural disaster or outbreak of a pandemic disease in China, or electrical shortages, labor shortages or work stoppages that may lead to higher production costs, production delays and/or transportation delays; changes in monetary controls and valuations of the Yuan by the Chinese government; increased costs of freight and transportation to meet delivery deadlines; violation of labor or other laws by our independent contract manufacturers, suppliers or licensees; potential imposition of additional duties, tariffs or other trade restrictions; business disruptions resulting from natural disasters such as an earthquake due to the location of our company's domestic warehouse, headquarters and a substantial number of retail stores in California; changes in business strategy or development plans; changes in economic conditions that could affect the Company's ability to open retail stores in new markets and/or the sales performance of the Company's existing stores; the ability to attract and retain qualified personnel; the disruption, expense and potential liability associated with existing or unanticipated future litigation; and other factors referenced or incorporated by reference in this report and other reports that we filed with the United States Securities and Exchange Commission (the "SEC").

The risks included here are not exhaustive. Other sections of this report may include additional factors that could adversely impact our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and we cannot predict all such risk factors, nor can we assess the impact of all such risk factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. Moreover, reported results shall not be considered an indication of our company's future performance. Investors should also be aware that while we do, from time to time, communicate with securities analysts, we do not disclose any material non-public information or other confidential commercial information to them. Accordingly, individuals should not assume that we agree with any statement or report issued by any analyst, regardless of the content of the report. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not our responsibility.

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**PART I**

**ITEM 1. BUSINESS**

We were incorporated in California in 1992 and reincorporated in Delaware in 1999. Throughout this annual report, we refer to Skechers U.S.A., Inc., a Delaware corporation, and its consolidated subsidiaries as we, us, our, company and Skechers unless otherwise indicated. Our Internet website address is [www.skechers.com](http://www.skechers.com). Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, Form 3's, 4's and 5's filed on behalf of directors, officers and 10% stockholders, and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge on our website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. You can learn more about us by reviewing such filings on our website or at the SEC's website at [www.sec.gov](http://www.sec.gov).

**GENERAL**

We design and market Skechers-branded contemporary footwear for men, women and children under several unique lines. Our footwear reflects a combination of style, quality and value that appeals to a broad range of consumers. In addition to Skechers-branded lines, we also offer eight uniquely branded designer, fashion and street-focused footwear lines for men, women and children. These lines are branded and marketed separately from Skechers and appeal to specific audiences. Our brands are sold through department stores, specialty stores, athletic retailers, and boutiques as well as our e-commerce website and our own retail stores. We operate 70 concept stores, 72 factory outlet stores and 35 warehouse outlet stores in the United States, and 14 concept stores and two factory outlets internationally. Our objective is to profitably grow our operations worldwide while leveraging our recognizable Skechers brand through our strong product lines, innovative advertising and diversified distribution channels.

We seek to offer consumers a vast array of fashionable footwear that satisfies their active, casual, dress casual and dress footwear needs. Our core consumers are style-conscious 12 to 24 year-old men and women attracted to our youthful brand image and fashion forward designs. Many of our best-selling and core styles are also developed for children with colors and materials that reflect a playful image appropriate for this demographic.

We believe that brand recognition is an important element for success in the footwear business. We have aggressively promoted our brands through comprehensive marketing campaigns for men, women and children. During 2007, we continued our celebrity driven ads with platinum recording artist Ashlee Simpson as our Skechers celebrity endorsee. We also developed television campaigns for our men's, women's and children's lines, including our first animated campaign for Airators by Skechers and Cali Gear from Skechers. In 2007, our marketing for children focused on television spots, while our adult efforts utilized television, print and outdoor. Select fashion brands including Marc Ecko Footwear are supported by television commercials. Our Unltd. by Marc Ecko Rhino Red and Zoo York footwear lines are also supported through print ads developed by Marc Ecko. The Red by Marc Ecko line was also supported by print and television campaigns featuring platinum recording artist and actress JoJo, and High School Musical stars Ashley Tisdale and Vanessa Hudgens.

Since we introduced our first line, Skechers USA Sport Utility Footwear, in December 1992, we have expanded our product offering and grown our net sales while substantially increasing the breadth and penetration of our account base. Our men's, women's and children's Skechers-branded product lines benefit from the Skechers reputation for contemporary and progressive styling, quality, comfort and affordability. Our lines that are not branded with the Skechers name benefit from our marketing support, quality management and expertise. To promote innovation and brand relevance, we manage our product lines separately by utilizing dedicated sales and design teams. Our product lines share back office services in order to limit our operating expenses and fully utilize our management's vast experience in the footwear industry.

**SKECHERS LINES**

***Skechers USA.*** Our Skechers USA category for men and women includes five types of footwear: (i) Casuals, (ii) Dress Casuals, (iii) Comfort and Lightweight (for men only), (iv) Outdoor (for men only) (v) Sandals and (vi) Casual Fusion. This category is generally sold through mid-tier retailers, department stores and some footwear specialty shops.

The Casuals line for men and women is defined by lugged outsoles and utilizes value-oriented and leather materials in the uppers. For men, the Casuals category includes black and brown boots, shoes and sandals that

generally have a rugged urban design some with industrial-inspired fashion features. For women, the Casuals category includes basic black and brown

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oxfords and slip-ons, lug outsole boots, and casual sandals. We design and price both the men's and women's categories to appeal primarily to younger consumers with broad acceptance across age groups.

For men, the Dress Casuals category is comprised of basic black and brown men's shoes that feature shiny leathers and dress details, but may utilize traditional or lugged outsoles as well as value-oriented materials. For women, the Dress Casual line is comprised of trend-influenced stylized boots and shoes, which may include leather uppers, shearling or faux fur lining or trim.

Skechers Comfort is a line of trend-right casuals for men who want all-day comfort without compromising style. Characteristics of the line include comfortable outsoles, cushioned insoles and quality leather uppers. As a category with unique features, we market and package the Skechers Comfort styles in a shoe box that is distinct from that of other categories in the Skechers USA line of footwear.

Our Outdoor styles for men primarily consist of hiker-influenced constructions including boots and shoes. While this category includes many technical performance features, we market this category of footwear primarily on the basis of style and comfort. Outsoles generally consist of molded and contoured hardened rubber. Many designs include gusseted tongues to prevent penetration of water and debris, cushioned mid-soles, motion control devices such as heel cups, water-resistant or water-proof construction and materials, and more durable hardware such as metal D-rings instead of eyelets. Uppers are generally constructed of heavily oiled nubuck and full-grain leathers.

Our Sandals collection for men and women is designed with many of our existing and proven outsoles for our Casuals, Dress Casuals and Casual Fusion lines, stylized with basic or core uppers as well as fresh looks. These styles are generally made with quality leather uppers, but may also be in canvas or fabric.

Our Casual Fusion line is comprised of low-profile, sport-influenced Euro casuals targeted at trend-conscious young men and women. The outsoles are primarily rubber and adopted from our men's Sport and women's Active lines. This collection features leather or nubuck uppers, but may also include mesh, and may be in shades of browns and beiges as well as in black, gray, greens and blues.

***Skechers Sport.*** Our Skechers Sport footwear for men and women includes: (i) Joggers, Trail Runners, Sport Hikers, Terrainers, (ii) Performance (for men only), (iii) Street Casuals and (iv) Sport Sandals. Our Skechers Sport category is distinguished by its technical performance-inspired looks; however, we generally do not promote the technical performance features of these shoes. Skechers Sport is typically sold through specialty shoe stores, department stores and athletic footwear retailers.

Our Jogger, Trail Runner, Sport Hiker and cross trainer-inspired Terrainer designs are lightweight constructions that include cushioned heels, polyurethane midsoles, phylon and other synthetic outsoles, as well as leather or synthetic uppers such as durabuck, cordura and nylon mesh. Careful attention is devoted to the design, pattern and construction of the outsoles, which vary greatly depending on the intended use. This category features earth tones and athletic-inspired hues with contrasting pop colors such as lime green, orange and red in addition to traditional athletic white.

The Performance category is comprised of multi-purpose running shoes that are marketed as men's lifestyle athletic footwear. Some styles include 3M reflective accents, breathable upper construction, quality leathers, abrasion-resistant toe and heel cap, removable moisture wicking molded ethyl vinyl acetate (EVA) sock liner, outsole forefoot flex grooves for improved flexibility, non-marking rubber lugs with impact dispersment technology (IDT), aggressive all terrain traction lugs, external torsion stabilizer and tuned dual-density molded EVA midsole with pronation control.



Street Casual incorporates lower profiles, classic details and skate, street and fusion influences in a collection of essential, basic casual sneakers. The uppers are designed in leather, suede, nubuck, canvas and/or mesh, and many include vulcanized outsoles. Street Casual is targeted to young consumers, but also appeals to a broader demographic.

Our Sport Sandals are primarily designed from existing Skechers Sport outsoles and may include many of the same sport features as our sneakers with the addition of new technologies geared toward making a comfortable sport sandal. Sport sandals are designed as seasonal footwear for the consumer who already wears our Skechers Sport sneakers.

***Skechers Active.*** A natural companion to Skechers Sport, Skechers Active has grown from a casual everyday line into a complete line of fusion and sport fusion sneakers for females of all ages. Marked by low-profile outsoles, the Active line is available in a multitude of colors as well as solid white or black, in fabrics, leathers and meshes, and with various closures — traditional laces, zig-

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zag and cross straps, among others. The line also now includes Mary Janes, sandals and open back styles. Active sneakers are typically retailed through specialty casual shoe stores and department stores.

***Skechers Cali.*** Launched in 2006, Skechers Cali is a line of sneakers, skimmers, wedges and sandals for young women designed to typify the California lifestyle. The uppers are primarily in canvas, fabrics and leather with unique prints, some with patch details. The sandals range from dress casual looks to casual to beach thongs. Skechers Cali is sold through specialty casual shoe stores and department stores.

***Skechers Work.*** Expanding on our heritage of cutting-edge utility footwear, Skechers Work offers a complete line of men's and women's casuals, field boots, hikers and athletic shoes. The Skechers Work line includes athletic-inspired, casual safety toe, and non-slip safety toe categories that may feature lightweight aluminum safety toe, electrical hazard, and slip-resistant technologies, as well as breathable, seam-sealed waterproof membranes. Designed for men and women with jobs that require certain safety requirements, these durable styles are constructed on high-abrasion, long wearing soles, and feature breathable lining, oil and abrasion resistant outsoles offering all-day comfort and prolonged durability. The uppers are comprised of high-quality leather, nubuck, trubuck and durabuck. Our safety toe athletic sneakers, boots, hikers, and casuals are ideal for environments requiring safety footwear and offer comfort and safety in dry or wet conditions. Our slip-resistant boots, hikers, athletics, casuals and clogs are ideal for the service industry. Our safety toe products have been independently tested and certified to meet ASTM standards, and our slip-resistant soles have been tested pursuant to the Mark II testing method for slip resistance. Skechers Work is typically sold through department stores, athletic footwear retailers and specialty shoe stores, as well as marketed directly to consumers through business-to-business channels.

***Skechers Kids.*** The Skechers Kids line includes: (i) Skechers Kids, which is a range of infants, toddlers, boys and girls boots, shoes and sneakers; (ii) S-Lights, which is lighted footwear for toddlers, boys and girls; (iii) Skechers Cali for Girls, which is trend-inspired boots, shoes, sandals and dress sneakers; (iv) Airators by Skechers; (v) Skechers Super Z-Strap; and (vi) Babiez by Skechers. Skechers Kids and Skechers Cali for Girls are comprised primarily of shoes that are designed as "takedowns" of their adult counterparts, allowing the younger set the opportunity to wear the same popular styles as their older siblings and schoolmates. This "takedown" strategy maintains the product's integrity by offering premium leathers, hardware and outsoles without the attendant costs involved in designing and developing new products. In addition, we adapt current fashions from our men's and women's lines by modifying designs and choosing colors and materials that are more suitable for the playful image that we have established in the children's footwear market. Each Skechers Kids line is marketed and packaged separately with a distinct shoe box. Skechers Kids shoes are available at department stores and specialty and athletic retailers.

The Skechers Kids line includes embellishments or adornments such as fresh colors and fabrics from our Skechers adult shoes. Some of these styles are also adapted for toddlers with softer, more pliable outsoles and for infants with soft, leather-sole crib shoes.

S-Lights is a line of sneakers and sandals with a combined pattern of lights on the outsole and other areas of the shoes. We market and package the S-Lights styles in a shoe box that is distinct from that of other categories in the Skechers Kids line of footwear.

Skechers Cali for Girls is a line of sneakers, skimmers and sandals for young women designed to typify the California lifestyle. The sneakers are designed primarily with canvas uppers in unique prints, some with patch details, on vulcanized outsoles. The skimmers and flats are designed with many of the same upper materials and outsoles as the sneakers.

Airators by Skechers is a line of boys sneakers with a foot-cooling system designed to pump air from the heel through to the toes.

Skechers Super Z-Strap is a line of athletic styled sneakers with a unique "z" shaped closure system for easy closure.

Babiez by Skechers is a line of crib shoes for infants. The uppers and outsoles are designed in leather and are extremely flexible for newborn feet.

***Cali Gear by Skechers.*** Launched in 2007, Cali Gear by Skechers is a new line of nano lite™ molded footwear for men, women and children. Designed with many of our signature outsoles as well as uppers, the lightweight footwear is available in a multitude of colors and patterns consistent with the Skechers image. The majority of styles for children, as well as some adult styles, are available with Skechers Cali Bits, which are decorative accessories inserted into designed holes in the uppers. The Skechers Cali Bits are also

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available for purchase and include licensed properties such as The Simpsons and Spiderman. The Cali Gear footwear is also non-slip and odor-resistant. Primarily displayed on hanging fixtures and wall units, the footwear is available at department stores, footwear specialty chains and independents.

### **FASHION AND STREET BRANDS**

The Fashion and Street Division and its brands are marketed and packaged separately from Skechers.

**Unltd. by Marc Ecko, Rhino Red and Red by Marc Ecko.** Unltd. by Marc Ecko is a line of men's street-inspired traditional sneakers, fusion sneakers and urban-focused casuals. Rhino Red is a line of women's classic and fashion-forward fusion sneakers sandals and Mary Janes for young women. Targeted to the street-savvy 18 to 34 year-old consumer, the footwear reflects Ecko Unltd.'s men's apparel and the Ecko Red women's apparel, and effectively utilizes the globally recognized Rhino logo on the majority of sneakers and casuals. Within the Rhino Red line is the Red by Marc Ecko offering, a line of designer dress and dress casual footwear for the urban chic woman. The men's and women's footwear collections are designed in leather, canvas, mesh, as well as other materials. Unltd. by Marc Ecko for boys and Rhino Red for girls sneaker lines primarily consist of takedowns from the adult Marc Ecko footwear lines with additional or different colorways geared toward children and that reflect the boys' and girls' Ecko Unltd. and Ecko Red clothing. The licensed brands are sold through select department stores and specialty retailers.

**Zoo York.** Zoo York footwear is a line of action sports and lifestyle footwear for men. Zoo York footwear is designed by Marc Ecko Enterprises and borrows from the color palette and trends from Zoo York apparel that targets core skaters and those that embrace skate fashion. Zoo York footwear is available in skate and specialty shops as well as select athletic and department stores.

**310 Motoring.** The 310 footwear collection for men utilizes top-quality leathers, a fashion-forward approach to design and comfort, and materials that are derived from 310 Motoring's customized cars, including wood burl and carbon fiber. A multi-tiered approach, the line consists of high-end and high-design boots and shoes, sophisticated driving-inspired shoes and boots, and stylized athletic. 310 footwear is available in select department stores, specialty retailers and urban independents.

**Mark Nason and Siren by Mark Nason.** Mark Nason is a sophisticated and fashion forward footwear collection, marketed to style-conscious men, designed to complement designer denim and dress casual wear. Primarily crafted and constructed in Italy, the Mark Nason collection is comprised of classic and modern boots, shoes and sandals with distinctive profiles and luxurious hand-distressed leathers. The Mark Nason line distinguishes itself with high quality individual styling and may utilize unique materials such as premium leathers, etched and tattooed leathers, hand-treated, hand-scraped and hand-cut leathers, hand-treated leather uppers and soles, snakeskin and eel skin. Siren by Mark Nason is the ultimate accompaniment to designer denim and casual couture for discerning women. The line's boots are fueled with bold profiles, alluring details and distinct textures. Handcrafted in Italy, the boots utilize premium leathers, hand-treated details, leather outsoles, and some may include snakeskin and other exotic materials. The Mark Nason lines are available in better department stores and boutiques.

**SoHo Lab.** Targeting 18 to 34 year-old trend-savvy women and men, SoHo Lab is comprised of stylish dress shoes, boots and sandals. The men's SoHo Lab collection includes classic tailored and fashion-forward lasts in a variety of styles. The women's styles also include heels and flats. The footwear is manufactured in Europe, Brazil and China. The men's styles are typically sold in department stores, specialty stores and independent merchants, while the women's styles are only available at Skechers retail stores.

### **PRODUCT DESIGN AND DEVELOPMENT**

Our principal goal in product design is to generate new and exciting footwear in all of our product lines with contemporary and progressive styles and comfort-enhancing performance features. Targeted to the active, youthful and style-savvy, we design most new styles to be fashionable and marketable to the 12 to 24 year-old consumer, while substantially all of our lines appeal to the broader range of 5 to 40 year-old consumers, with an exclusive selection for infants and toddlers. While some of our shoes have performance features, we generally do not position our shoes in the marketplace as technical performance shoes.

We believe that our products' success is related to our ability to recognize trends in the footwear markets and to design products that anticipate and accommodate consumers' ever-evolving preferences. We are able to quickly

translate the latest fashion trends into stylish, quality footwear at a reasonable price by analyzing and interpreting current and emerging lifestyle trends. Lifestyle trend information is compiled and analyzed by our designers from various sources, including the review and analysis of modern music, television, cinema, clothing, alternative sports and other trend-setting media; traveling to domestic and international fashion markets to identify and confirm current trends; consulting with our retail and e-commerce customers for information on current retail selling

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trends; participating in major footwear trade shows to stay abreast of popular brands, fashions and styles; and subscribing to various fashion and color information services. In addition, a key component of our design philosophy is to continually reinterpret and develop our successful styles in our brands' image.

The footwear design process typically begins about nine months before the start of a season. Our products are designed and developed primarily by our in-house design staff. To promote innovation and brand relevance, we utilize dedicated design teams, who report to our senior design executives and focus on each of the men's, women's and children's categories. In addition, we utilize outside design firms on an item-specific basis to supplement our internal design efforts. The design process is extremely collaborative, as members of the design staff frequently meet with the heads of retail, merchandising, sales, production and sourcing to further refine our products to meet the particular needs of the target market.

After a design team arrives at a consensus regarding the fashion themes for the coming season, the designers then translate these themes into our products. These interpretations include variations in product color, material structure and embellishments, which are arrived at after close consultation with our production department. Prototype blueprints and specifications are created and forwarded to our manufacturers for a design prototype. The design prototypes are then sent back to our design teams. Our major retail customers may also review these new design concepts. Customer input not only allows us to measure consumer reaction to the latest designs, but also affords us an opportunity to foster deeper and more collaborative relationships with our customers. We also occasionally order limited production runs that may initially be tested in our concept stores. By working closely with store personnel, we obtain customer feedback that often influences product design and development. Our design teams can easily and quickly modify and refine a design based on customer input. Generally, the production process can take six months to nine months from design concept to commercialization.

**SOURCING**

**Factories.** Our products are produced by independent contract manufacturers located primarily in China and, to a lesser extent, in Italy, Vietnam, Brazil and various other countries. We do not own or operate any manufacturing facilities as we believe that the use of independent manufacturers substantially increases our production flexibility and capacity while reducing capital expenditures and avoiding the costs of managing a large production work force.

When possible, we seek to use manufacturers that have previously produced our footwear, which we believe enhances continuity and quality while controlling production costs. We attempt to monitor our selection of independent factories to ensure that no one manufacturer is responsible for a disproportionate amount of our merchandise. We source product for styles that account for a significant percentage of our net sales from at least four different manufacturers. During 2007, four of our contract manufacturers accounted for approximately 58.4% of total purchases. One manufacturer accounted for 29.7%, and two others each accounted for over 10.0% of our total purchases. To date, we have not experienced difficulty in obtaining manufacturing services.

We finance our production activities in part through the use of interest-bearing open purchase arrangements with certain of our Asian manufacturers. These facilities currently bear interest at a rate between 0% and 1.5% for 30 to 60 days financing, depending on the factory. We believe that the use of these arrangements afford us additional liquidity and flexibility. We do not have any long-term contracts with any of our manufacturers; however, we have long-standing relationships with many of our manufacturers and believe our relationships to be good.

We closely monitor sales activity after initial introduction of a product in our concept stores to determine whether there is substantial demand for a style, thereby aiding us in our sourcing decisions. Styles that have substantial consumer appeal are highlighted in upcoming collections or offered as part of our periodic style offerings, while less popular styles can be discontinued after only a limited production run. We believe that sales in our concept stores can also help forecast sales in national retail stores, and we share this sales information with our wholesale customers. Sales, merchandising, production and allocations management analyze historical and current sales and market data from our wholesale account base and our own retail stores to develop an internal product quantity forecast that allows us to better manage our future production and inventory levels. For those styles with high sell-through percentages, we maintain an in-stock position to minimize the time necessary to fill customer orders by placing orders with our manufacturers prior to the time we receive customers' orders for such footwear.

***Production Oversight.*** To safeguard product quality and consistency, we oversee the key aspects of production from initial prototype manufacture through initial production runs to final manufacture. Monitoring of all production is performed in the United States by our in-house production department and in Asia through an approximately 250-person staff working from our offices in China. We believe that our Asian presence allows us to negotiate supplier and manufacturer arrangements more effectively, decrease

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product turnaround time and ensure timely delivery of finished footwear. In addition, we require our manufacturers to certify that neither convicted, forced or indentured labor (as defined under U.S. law) nor child labor (as defined by law in the manufacturer's country) is used in the production process, and that compensation will be paid according to local law and that the factory is in compliance with local safety regulations.

**Quality Control.** We believe that quality control is an important and effective means of maintaining the quality and reputation of our products. Our quality control program is designed to ensure that not only finished goods meet our established design specifications, but also that all goods bearing our trademarks meet our standards for quality. Our quality control personnel located in China perform an array of inspection procedures at various stages of the production process, including examination and testing of prototypes of key raw materials prior to manufacture, samples and materials at various stages of production and final products prior to shipment. Our employees are on-site at each of our major manufacturers to oversee production. For some of our lower volume manufacturers, our staff is on-site during significant production runs or we will perform unannounced visits to their manufacturing sites to further monitor compliance with our manufacturing specifications.

### ADVERTISING AND MARKETING

With a marketing philosophy of Unseen, Untold, Unsold, we take a targeted approach to marketing to drive traffic, build brand recognition and properly position our diverse lines within the marketplace. Senior management is directly involved in shaping our image and the conception, development and implementation of our advertising and marketing activities. The focus of our marketing plan is print and television advertising, which is supported by outdoor, trend-influenced marketing, public relations, promotions and in-store support. In addition, we utilize celebrity endorsers in our advertisements. We also believe our Internet websites and trade shows are effective marketing tools to both consumers and corporate accounts. We have historically budgeted advertising as a percentage of projected net sales.

**Advertising.** The majority of our advertising is conceptualized by our in-house design team. We believe that our advertising strategies, methods and creative campaigns are directly related to our success. Through our lifestyle and image-driven advertising, we generally seek to build and increase brand awareness by linking the Skechers brand and our fashion and street brands to youthful, contemporary lifestyles and attitudes. We have built on this approach by featuring select styles in our lifestyle ads. In addition to our compelling Skechers lifestyle ads, we have also created product specific ads for our men's lines to appeal to men as well as women who purchase footwear for men. Our ads are designed to provide merchandise flexibility and to facilitate the brands and product designs' direction of evolving footwear fashions and consumer preferences.

To further build brand awareness and influence consumer spending, we have selectively signed endorsement agreements with celebrities whom we believed would reach new markets. In 2006, we signed pop star Ashlee Simpson to appear in Skechers marketing campaigns through 2007. In past years, we had similar endorsement agreements for Skechers with singers Carrie Underwood, Christina Aguilera and Britney Spears, professional basketball player and actor Rick Fox, and actors Robert Downey, Jr., Matt Dillon and Rob Lowe. From time to time, we may sign other celebrities to endorse our brand name and image in order to strategically market our products among specific consumer groups in the future.

In addition to advertising our Skechers branded lines through men's, women's and children's ads, we also support Mark Nason, 310, Marc Ecko and Zoo York lines through individual unique print and/or television advertisements some which may include celebrity endorsees. For Mark Nason, we have focused on key-selling styles in product-driven ads that captured the brand's essence. For the Marc Ecko footwear brands, Marc Ecko's design team has created relevant targeted print and television commercials for men and women. These include a multi-media men's campaign featuring our graffiti painted shoe as well as the first commercial for Unltd. by Marc Ecko for boys. In 2007, singer/actress JoJo became the new face of Rhino Red and appeared in print and outdoor advertising and a television commercial, and in late 2007, High School Musical stars Ashley Tisdale and Vanessa Hudgens became the faces of Red by Marc Ecko, appearing in print campaigns. Television commercials have also been developed and are being run in 2008.

With a targeted approach, our print ads appear regularly in popular fashion and lifestyle consumer publications, such as *GQ*, *Cosmopolitan*, *Elle*, *Lucky*, *In Style*, *Seventeen*, *Maxim*, *Slam*, *Road & Track*, and *Complex*, as well as in



weekly publications such as *People*, *Us Weekly*, *Star*, *Sports Illustrated* and *InTouch*, among others.

Our television commercials are produced both in-house and through producers we have utilized in the past and are familiar with our brands. In 2007, we developed commercials for men, women and children for our Skechers brands, including our first animated spots for Airators by Skechers and Cali Gear by Skechers for kids. We have found these to be a cost-effective way to advertise during

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key national and cable programming in key selling seasons. Our media buyer strategically selects the ideal programs and geographic areas for our commercials for maximum consumer impact.

**Outdoor.** In an effort to reach consumers where they shop and in high traffic areas as they travel to and from work or while running errands, we continued our multi-level outdoor campaign that included kiosks in key malls across the United States, and billboards, transportation systems and telephone kiosks in North America and Europe. We believe these are effective and efficient ways to reach a broad range of consumers and leave a lasting impression of our many brands.

**Trend-Influenced Marketing/Public Relations.** Our public relations objectives are to secure product placement in key fashion magazines, place our footwear on the feet of trend-setting celebrities, and garner positive and accurate press on our company. Through our commitment to aggressively promote our upcoming styles, our products are often featured in leading fashion and pop culture magazines, as well as in select films and popular television shows. Our footwear and our company have been prominently displayed and referenced on news and magazine shows including *The Today Show*, *Good Day L.A.*, *Entertainment Tonight*, and *E!*; and on television programs, including *Law & Order*, *Entourage*, and *The Big Idea with Donny Deutsch*, among others. We have also amassed an array of prominent product placements in magazines including *Lucky*, *Seventeen*, *OK!*, *Teen Vogue*, *CosmoGirl*, *InStyle*, *Maxim*, *Slam*, *Dime* and *Footwear News*. In addition, our brands have been associated with cutting edge events and select celebrities, and our product has been seen worn by trend-setters like Denis Leary, Chris Cornell, Debra Messing, Nicole Richie, Paris Hilton and Jamie Foxx, among others.

**Promotions.** By applying creative sales techniques via a broad spectrum of mediums, our marketing team seeks to build brand recognition and drive traffic to Skechers retail stores, websites and our retail partners locations. Skechers promotional strategies have encompassed in-store specials, charity events, product tie-ins and giveaways, and collaborations with national retailers and radio stations. Our imaginative promotions are consistent with Skechers imaging and lifestyle.

**Visual Merchandising.** Our in-house visual merchandising department supports wholesale customers, distributors and our retail stores by developing displays that effectively leverage our products at the point of sale. Our point-of-purchase display items include signage, graphics, displays, counter cards, banners and other merchandising items for each of our brands. These materials mirror the look and feel of each brand and reinforce the image as well as draw consumers into stores.

Our visual merchandising coordinators ( VMC s ) work with our sales force and directly with our customers to ensure better sell-through at the retail level by generating greater consumer awareness through Skechers brand displays. Our VMC s communicate with and visit our wholesale customers on a regular basis to aid in proper display of our merchandise. They also run in-store promotions to enhance the sale of Skechers footwear and create excitement surrounding the Skechers brand. We believe that these efforts help stimulate impulse sales and repeat purchases.

**Trade Shows.** To better showcase our diverse products to footwear buyers in the United States and Europe, and to distributors around the world, we regularly exhibit at leading trade shows. Along with specialty trade shows, we exhibit at WSA s The Shoe Show, FFANY, ASR and MAGIC in the United States, and GDS, MICAM, Bread & Butter, MODA, MIDECE and Who s Next in Europe. Our dynamic, state-of-the-art trade show exhibits are developed by our in-house architect to showcase our latest product offerings in a lifestyle setting reflective of each of our brands. By investing in innovative displays and individual rooms showcasing each line, our sales force can present a sales plan for each line and buyers are able to truly understand the breadth and depth of our offerings, thereby optimizing commitments and sales at the retail level. For select non-Skechers branded lines such as 310, Zoo York and Marc Ecko Footwear, we have created individual exhibits to ensure their brand integrity.

**Internet.** We also promote our brands through our e-commerce websites [www.skechers.com](http://www.skechers.com) and [www.soholab.com](http://www.soholab.com) to consumers who access the Internet. We have also established a unique Internet website for Mark Nason ([www.marknason.com](http://www.marknason.com)) designed to serve primarily as a marketing tool. These websites currently enable us to present information on our products, provide a brand experience and store locations to consumers, and allow consumers the ability to directly order products on the Internet. These sites also provide us a mechanism for customer feedback as well as allowing us to receive and respond directly to consumer feedback. Our websites are intended to enhance the Skechers and fashion brands and increase sales through all our retail channels. Our websites also allow us

to leverage our brand awareness at a lower cost than traditional distribution channels.

#### PRODUCT DISTRIBUTION CHANNELS

We have four reportable segments – domestic wholesale sales, international wholesale sales, retail sales and e-commerce sales. In the United States, our products are available through a network of wholesale customers comprised of department, athletic and

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specialty stores. Internationally, our products are available through wholesale customers in more than 100 countries and territories through our global network of distributors and our Canadian, Brazilian, Asian and European subsidiaries. Skechers owns and operates retail stores both domestically and internationally through three integrated retail formats: concept, factory outlet and warehouse outlet stores. Each of these channels serves an integral function in the global distribution of our products. Fourteen distributors have opened 60 distributor-owned Skechers retail stores in 21 countries as of December 31, 2007.

***Domestic Wholesale.*** We distribute our footwear through the following domestic wholesale distribution channels: department stores, specialty stores, athletic shoe stores and independent retailers. Department stores and specialty retailers are the largest distribution channels, but we believe that we appeal to a variety of wholesale customers, many of whom may operate stores within the same retail location due to our distinct product lines and variety of styles, from which retailers can select those lines and styles that best satisfy the fashion, function and price criteria of their specific customers. Management has a clearly defined growth strategy for each of our channels of distribution. An integral component of our strategy is to offer our accounts the highest level of customer service so that our products will be fully represented in existing retail locations and new locations of each customer.

In an effort to provide knowledgeable and personalized service to our wholesale customers, the sales force is segregated by product line, each of which is headed by a vice president or national sales manager. Reporting to each sales manager are knowledgeable account executives and territory managers. Our vice presidents and national sales managers report to a senior vice president of sales. All of our vice presidents and national sales managers are compensated on a salary basis, while our account executives and territory managers are compensated on a commission basis. None of our domestic sales personnel sells competing products.

We believe that we have developed a loyal customer base through exceptional customer service. We believe that our close relationships with these accounts help us to maximize their retail sell-throughs. Our visual merchandise coordinators work with our wholesale customers to ensure that our merchandise and point-of-purchase marketing materials are properly presented. Sales executives and merchandise personnel work closely with accounts to ensure that appropriate styles are purchased for specific accounts and for specific stores within those accounts as well as to ensure that appropriate inventory levels are carried at each store. Such information is then utilized to help develop sales projections and determine the product needs of our wholesale customers. The value-added services we provide our wholesale customers help us maintain strong relationships with our existing wholesale customers and attract potential new wholesale customers.

***International Wholesale.*** Our products are sold in more than 100 countries and territories throughout the world. We generate revenues from outside the United States from three principal sources: (i) direct sales to department stores and specialty retail stores through our subsidiaries in Canada, France, Germany, Spain, Italy, Portugal, Switzerland, Austria, Malaysia, Thailand, the Benelux Region, the United Kingdom and Brazil; (ii) sales to foreign distributors who distribute our footwear to department stores and specialty retail stores in countries and territories across Eastern Europe, Asia, Latin America, South America, Africa, the Middle East and Australia, among other regions and (iii) to a lesser extent, royalties from licensees who manufacture and distribute our non-footwear products outside the United States.

We believe that international distribution of our products represents a significant opportunity to increase sales and profits. We intend to further increase our share of the international footwear market by heightening our marketing in those countries in which we currently have a presence through our international advertising campaigns, which are designed to establish Skechers as a global brand synonymous with trend-right casual shoes.

### ***International Subsidiaries***

#### ***Europe***

We currently distribute product in most of Western Europe through the following subsidiaries: Skechers USA Ltd., with its offices and showrooms in London, England; Skechers S.a.r.l., with its offices and showrooms in Lausanne, Switzerland; Skechers USA France S.A.S., with its offices and showrooms in Paris, France; Skechers USA Deutschland GmbH, with its offices and showrooms in Dietzenbach, Germany; Skechers USA Iberia, S.L., with its offices and showrooms in Madrid, Spain; Skechers USA Benelux B.V., with its offices and showrooms in Waalwijk, the Netherlands; and Skechers USA Italia S.r.l., with its offices and showroom in Verona, Italy.



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Skechers-owned retail stores in Europe include eight concept stores and one factory outlet store located in five countries, including the key locations of Oxford Street in London, Altstadt District in Düsseldorf and Kalverstraat Street in Amsterdam.

To accommodate our European subsidiaries' operations, we operate an approximately 240,000 square foot distribution center in Liege, Belgium. This distribution center is currently used to store and deliver product to our subsidiaries and retail stores throughout Europe.

*Canada*

Merchandising and marketing of our product in Canada is managed by our wholly-owned subsidiary, Skechers USA Canada, Inc. with its offices and showrooms outside Toronto in Mississauga, Ontario. Product sold in Canada is primarily sourced from our U.S. distribution center in Ontario, California. We have two concept stores, one located in Toronto's Eaton Centre, and one in the West Edmonton Mall and one factory outlet store located in Toronto.

*Malaysia and Thailand*

Merchandising and marketing of our product in Asia is managed by two of our wholly-owned subsidiaries, Skechers Malaysia Sdn Bhd and Skechers (Thailand) Ltd. with their respective offices in Kuala Lumpur, Malaysia and Bangkok, Thailand. Product sold in Asia is primarily sourced from a third party distribution center in Selangor, Malaysia. We have four concept stores, one located in Kuala Lumpur, Malaysia, two located in Selangor, Malaysia, and one in Bangkok, Thailand.

*Brazil*

Merchandising and marketing of our product in Brazil is managed by our wholly-owned subsidiary, Skechers Do Brasil Calçados LTDA., with its offices located in Sao Paulo, Brazil. Product sold in Brazil is primarily shipped directly from our contract manufacturer's factories in China and occasionally from our U.S. distribution center in Ontario, California.

***Distributors***

Outside of Western Europe and Canada, our footwear is distributed through an extensive network of more than 30 distributors, who sell our products to department, athletic and specialty stores in more than 100 countries around the world. Through agreements with 14 of these distributors, 60 distributor-owned Skechers retail stores are open in 21 countries, including 13 stores that were opened in 2007. One distributor-owned store was closed and two became company operated in 2007.

| <b>REGION</b>                        | <b>STORE<br/>FORMAT</b> | <b>NUMBER<br/>OF<br/>STORES</b> | <b>LOCATION<sup>(1)</sup></b>                                                                      |
|--------------------------------------|-------------------------|---------------------------------|----------------------------------------------------------------------------------------------------|
| <i>Asia</i>                          | Concept                 | 4                               | Japan (2); Philippines; Taiwan                                                                     |
|                                      | Warehouse               | 4                               | Japan (4)                                                                                          |
| <i>Australia</i>                     | Concept                 | 1                               | Sydney                                                                                             |
|                                      | Warehouse               | 2                               | Melbourne, Sydney                                                                                  |
| <i>Central America/South America</i> | Concept                 | 34                              | Chile (10); Columbia (8); Ecuador; El Salvador; Guatemala (2); Panama (4); Peru (2); Venezuela (6) |
| <i>Eastern Europe</i>                | Concept                 | 7                               | Baltics (2); Greece; Poland; Russia (2); Ukraine                                                   |
| <i>Northern Europe</i>               | Concept                 | 1                               | Finland                                                                                            |
| <i>Middle East</i>                   | Concept                 | 6                               | Saudi Arabia; UAE (5)                                                                              |
| <i>South Africa</i>                  | Concept                 | 1                               | Sandton                                                                                            |

(1) One store per location except as otherwise noted.

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The distributors are responsible for their respective store's operations, have ownership of their respective store's assets and select the broad collection of our products to sell to consumers in their regions. In order to maintain a globally consistent image, we provide architectural, graphic and visual guidance and materials for the design of the stores, and we train the local staff on our products and corporate culture. We intend to expand our international presence and global recognition of the Skechers brand name by continuing to sell our footwear to foreign distributors and by opening flagship retail stores with distributors that have local market expertise.

***Retail Stores.*** We pursue our retail store strategy through our three integrated retail formats: the concept store, the factory outlet store and the warehouse outlet store. Our three-store format enables us to promote the full Skechers product offering in an attractive environment that appeals to a broad group of consumers. In addition, most of our retail stores are profitable and have a positive effect on our operating results. As of February 15, 2008, we owned and operated 70 concept stores, 72 factory outlet stores and 35 warehouse outlet stores in the United States, and 14 concept stores and two factory outlet stores internationally. We closed three stores and opened 42 new stores in 2007. We plan to open an additional 25 to 30 stores by the end of 2008.

***Concept Stores.***

Our concept stores are located at either marquee street locations or in major shopping malls in large metropolitan cities. Our concept stores have a threefold purpose in our operating strategy. First, concept stores serve as a showcase for a wide range of our product offering for the current season as we estimate that our average wholesale customer carries no more than 5% of the complete Skechers line in any one location. Our concept stores showcase our products in a cutting-edge, open-floor setting, providing the customer with the complete Skechers story. Second, retail locations are generally chosen to generate maximum marketing value for the Skechers brand name through signage, store front presentation and interior design. Domestic locations include concept stores at Times Square and 34th Street in New York, Hollywood and Highland in Hollywood, Santa Monica's Third Street Promenade, Dallas' Northpark Center, Las Vegas' Fashion Show Mall, Seattle's Bellevue Square Mall, and Woodfield Mall outside Chicago. International locations include Oxford Street in London, Altstadt District in Dusseldorf, Toronto's Eaton Centre, Kalverstraat Street in Amsterdam. The stores are typically designed to create a distinctive Skechers look and feel, and enhance customer association of the Skechers brand name with current youthful lifestyle trends and styles. Third, the concept stores serve as marketing and product testing venues. We believe that product sell-through information and rapid customer feedback derived from our concept stores enables our design, sales, merchandising and production staff to respond to market changes and new product introductions. Such responses serve to augment sales and limit our inventory markdowns and customer returns and allowances. We opened 24 domestic concept stores and four international concept stores, and we closed one domestic concept store and one international concept store in 2007.

The typical Skechers concept store is approximately 2,500 square feet, although in certain markets we have opened concept stores as large as 6,400 square feet or as small as 1,500 square feet. When deciding where to open concept stores, we identify top geographic markets in the larger metropolitan cities in the United States, Canada, Europe and Asia. When selecting a specific site, we evaluate the proposed site's traffic pattern, co-tenancies, sales volume of neighboring concept stores, lease economics and other factors considered important within the specific location. If we are considering opening a concept store in a shopping mall, our strategy is to obtain space as centrally located as possible in the mall where we expect foot traffic to be most concentrated. We believe that the strength of the Skechers brand name has enabled us to negotiate more favorable terms with shopping malls that want us to open up concept stores to attract customer traffic to their venues.

***Factory Outlet Stores.***

Our factory outlet stores are generally located in manufacturers' direct outlet centers throughout the United States. In addition, we have two international outlet stores—one in Canada and one in England. Our factory outlet stores provide opportunities for us to sell discontinued and excess merchandise, thereby reducing the need to sell such merchandise to discounters at excessively low prices and potentially compromise the Skechers brand image. Skechers factory outlet stores range in size from approximately 1,900 to 9,000 square feet. Inventory in these stores is supplemented by certain first-line styles sold at full retail price points. We opened 11 domestic factory outlet stores in 2007.

***Warehouse Outlet Stores.***

Our free-standing warehouse outlet stores, which are located throughout the United States, enable us to liquidate excess merchandise, discontinued lines and odd-size inventory in a cost-efficient manner. Skechers' warehouse outlet stores range in size from approximately 5,200 to 13,500 square feet. Our warehouse outlet stores enable us to sell discontinued and excess



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merchandise that would otherwise typically be sold to discounters at excessively low prices, which could otherwise compromise the Skechers brand image. We seek to open our warehouse outlet stores in areas that are in close proximity to our concept stores in order to facilitate the timely transfer of inventory that we want to liquidate as soon as practicable. We opened three new domestic warehouse outlet stores and closed one domestic warehouse store in 2007.

**Electronic Commerce.** Our websites, [www.skechers.com](http://www.skechers.com) and [www.soholab.com](http://www.soholab.com) are virtual storefronts that promote the Skechers and street and fashion brands. Our websites are designed to provide a positive shopping and brand experience, showcasing our products in an easy-to-navigate format, allowing consumers to browse our selections and purchase our footwear. This virtual store has provided a convenient alternative-shopping environment and brand experience. These websites have become an efficient and effective additional retail distribution channel, and have improved our customer service.

### **LICENSING**

We believe that selective licensing of the Skechers brand name and our product line names to manufacturers may broaden and enhance the individual brands without requiring significant capital investments or additional incremental operating expenses. Our multiple product lines plus additional subcategories present many potential licensing opportunities on terms with licensees that we believe will provide more effective manufacturing, distribution or marketing of non-footwear products. We also believe that the reputation of Skechers and its history in launching brands has also enabled us to partner with reputable non-footwear brands in order to design and market their footwear.

As of January 31, 2008, we had 24 active domestic and international licensing agreements in which we are the licensor. We have international licensing agreements for the design and distribution of men's and women's active apparel in Israel; men's and women's apparel in select European countries; bags in select Central and South American countries; watches in the Philippines, and bags in China.

Additionally, we have signed agreements to design, develop and market footwear for the street lifestyle apparel brands Ecco Unltd., Ecco Red, Red by Marc Ecco, and Zoo York under the Marc Ecco Enterprises umbrella.

### **DISTRIBUTION FACILITIES AND OPERATIONS**

We believe that strong distribution support is a critical factor in our operations. Once manufactured, our products are packaged in shoe boxes bearing bar codes that are shipped either (i) to our five distribution centers located in Ontario, California, which measure in aggregate approximately 1.7 million square-feet; (ii) to our approximately 240,000 square-foot distribution center located in Liege, Belgium or (iii) directly from third-party manufacturers to our other international customers and other international third party distribution centers. Upon receipt at either of the distribution centers, merchandise is inspected and recorded in our management information system and packaged according to customers' orders for delivery. Merchandise is shipped to customers by whatever means each customer requests, which is usually by common carrier. The distribution centers have multi-access docks, enabling us to receive and ship simultaneously, and to pack separate trailers for shipments to different customers at the same time. We have an electronic data interchange system, or EDI system, to which some of our larger customers are linked. This system allows these customers to automatically place orders with us, thereby eliminating the time involved in transmitting and inputting orders, and it includes direct billing and shipping information.

During 2007, we entered into a lease to build a new approximately 1.8 million square foot distribution facility in Moreno Valley, California. Once completed, we will occupy the facility under an eleven-year lease with one option to extend the lease four years followed by two options to extend the lease by additional five-year terms, and we will move out of our existing distribution facilities in Ontario, California.

### **BACKLOG**

As of December 31, 2007, our backlog was \$416.5 million, compared to \$322.9 million as of December 31, 2006. While backlog orders are subject to cancellation by customers, we have not experienced significant cancellation of orders in the past, and we expect that substantially all the orders will be shipped in 2008. However, for a variety of reasons, including changes in the economy, customer demand for our products, the timing of shipments, product mix of customer orders, the amount of in-season orders and a shift towards tighter lead times within backlog levels, backlog may not be a reliable measure of future sales for any succeeding period.



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### **INTELLECTUAL PROPERTY RIGHTS**

We own and utilize a variety of trademarks, including the Skechers trademark. We have a significant number of both registrations and pending applications for our trademarks in the United States. In addition, we have trademark registrations and trademark applications in approximately 80 foreign countries. We also have design patents and pending design and utility patent applications in both the United States and approximately 25 foreign countries. We continuously look to increase the number of our patents and trademarks both domestically and internationally where necessary to protect valuable intellectual property. We regard our trademarks and other intellectual property as valuable assets and believe that they have significant value in the marketing of our products. We vigorously protect our trademarks against infringement, including through the use of cease and desist letters, administrative proceedings and lawsuits.

We rely on trademark, patent, copyright and trade secret protection, non-disclosure agreements and licensing arrangements to establish, protect and enforce intellectual property rights in our logos, tradenames and in the design of our products. In particular, we believe that our future success will largely depend on our ability to maintain and protect the Skechers trademark and other key trademarks. Despite our efforts to safeguard and maintain our intellectual property rights, we cannot be certain that we will be successful in this regard. Furthermore, we cannot be certain that our trademarks, products and promotional materials or other intellectual property rights do not or will not violate the intellectual property rights of others, that our intellectual property would be upheld if challenged, or that we would, in such an event, not be prevented from using our trademarks or other intellectual property rights. Such claims, if proven, could materially and adversely affect our business, financial condition and results of operations. In addition, although any such claims may ultimately prove to be without merit, the necessary management attention to and legal costs associated with litigation or other resolution of future claims concerning trademarks and other intellectual property rights could materially and adversely affect our business, financial condition and results of operations. We have sued and have been sued by third parties for infringement of intellectual property. It is our opinion that none of these claims has materially impaired our ability to utilize our intellectual property rights.

The laws of certain foreign countries do not protect intellectual property rights to the same extent or in the same manner as do the laws of the United States. Although we continue to implement protective measures and intend to defend our intellectual property rights vigorously, these efforts may not be successful or the costs associated with protecting our rights in certain jurisdictions may be prohibitive. From time to time we discover products in the marketplace that are counterfeit reproductions of our products or that otherwise infringe upon intellectual property rights held by us. Actions taken by us to establish and protect our trademarks and other intellectual property rights may not be adequate to prevent imitation of our products by others or to prevent others from seeking to block sales of our products as violating trademarks and intellectual property rights. If we are unsuccessful in challenging a third party's products on the basis of infringement of our intellectual property rights, continued sales of such products by that or any other third party could adversely impact the Skechers brand, result in the shift of consumer preferences away from our products and generally have a material adverse effect on our business, financial condition and results of operations.

### **COMPETITION**

Competition in the footwear industry is intense. Although we believe that we do not compete directly with any single company with respect to its entire range of products, our products compete with other branded products within their product category as well as with private label products sold by retailers, including some of our customers. Our utility footwear and casual shoes compete with footwear offered by companies such as The Timberland Company, Dr. Martens, Kenneth Cole Productions Inc., Steven Madden, Ltd., Wolverine World Wide, Inc., V.F. Corporation, and CROCS, Inc. Our athletic lifestyle shoes compete with footwear offered by companies such as Nike, Inc., adidas AG, Puma AG, New Balance Athletic Shoe, Inc. and K-Swiss Inc. Our children's shoes compete with footwear offered by companies such as Collective Brands Inc. In varying degrees, depending on the product category involved, we compete on the basis of style, price, quality, comfort and brand name prestige and recognition, among other considerations. These and other competitors pose challenges to our market share in our major domestic markets and may make it more difficult to establish our products in Europe, Asia and other international regions. We also compete with numerous manufacturers, importers and distributors of footwear for the limited shelf space available for the

display of such products to the consumer. Moreover, the general availability of contract manufacturing capacity allows ease of access by new market entrants. Many of our competitors are larger, have been in existence for a longer period of time, have achieved greater recognition for their brand names, have captured greater market share and/or have substantially greater financial, distribution, marketing and other resources than we do. We cannot be certain that we will be able to compete successfully against present or future competitors, or that competitive pressures will not have a material adverse effect on our business, financial condition and results of operations.

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**EMPLOYEES**

As of February 1, 2008, we employed 4,182 persons, 2,157 of whom were employed on a full-time basis and 2,025 of whom were employed on a part-time basis. None of our employees are subject to a collective bargaining agreement. We believe that our relations with our employees are satisfactory.

**ITEM 1A. RISK FACTORS**

In addition to the other information in this annual report, the following factors should be considered in evaluating us and our business.

**Our Future Success Depends On Our Ability To Respond To Changing Consumer Demands, Identify And Interpret Fashion Trends And Successfully Market New Products.**

The footwear industry is subject to rapidly changing consumer demands and fashion trends. Accordingly, we must identify and interpret fashion trends and respond in a timely manner. Demand for and market acceptance of new products are uncertain and achieving market acceptance for new products generally requires substantial product development and marketing efforts and expenditures. If we do not continue to meet changing consumer demands and develop successful styles in the future, our growth and profitability will be negatively impacted. We frequently make decisions about product designs and marketing expenditures several months in advance of the time when consumer acceptance can be determined. If we fail to anticipate, identify or react appropriately to changes in styles and trends or are not successful in marketing new products, we could experience excess inventories, higher than normal markdowns or an inability to profitably sell our products. Because of these risks, a number of companies in the footwear industry specifically, and others in the fashion and apparel industry in general, have experienced periods of rapid growth in revenues and earnings and thereafter periods of declining sales and losses, which in some cases have resulted in companies in these industries ceasing to do business. Similarly, these risks could have a material adverse effect on our results of operations or financial condition.

**Our Business And The Success Of Our Products Could Be Harmed If We Are Unable To Maintain Our Brand Image.**

Our success to date has been due in large part to the strength of the Skechers brand, and to a lesser degree, the reputation of our fashion brands. If we are unable to timely and appropriately respond to changing consumer demand, our brand name and brand image may be impaired. Even if we react appropriately to changes in consumer preferences, consumers may consider our brand image to be outdated or associate our brand with styles of footwear that are no longer popular. In the past, several footwear companies including ours have experienced periods of rapid growth in revenues and earnings followed by periods of declining sales and losses. Our business may be similarly affected in the future.

**Our Business May Be Negatively Impacted As A Result Of Changes In The Economy.**

Our business depends on the general economic environment and levels of consumer spending in the United States and other parts of the world that affect not only the ultimate consumer, but also retailers, who are our primary direct customers. Purchases of footwear tend to decline in periods of recession or uncertainty regarding future economic prospects, when consumer spending, particularly on discretionary items, declines. During periods of recession or economic uncertainty, we may not be able to maintain or increase our sales to existing customers, make sales to new customers, open and operate new retail stores, maintain sales levels at our existing stores, maintain or increase our international operations on a profitable basis, or maintain or improve our earnings from operations as a percentage of net sales. In addition, the continued threat of terrorist attacks throughout the world similar to those on September 11, 2001, and the military action, or possible military action, taken by the United States and other nations in Iraq or other countries may cause significant disruption to commerce throughout the world. As a result, our operating results may be adversely and materially affected by downward trends in the domestic economy or the occurrence of events that slow the global economy or, more particularly, result in delays or cancellations of purchase orders for our products.

**Our Business Could Be Harmed If We Fail To Maintain Proper Inventory Levels.**

We place orders with our manufacturers for some of our products prior to the time we receive all of our customers orders. We do this to minimize purchasing costs, the time necessary to fill customer orders and the risk of non-delivery. We also maintain an



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inventory of certain products that we anticipate will be in greater demand. However, we may be unable to sell the products we have ordered in advance from manufacturers or that we have in our inventory. Inventory levels in excess of customer demand may result in inventory write-downs, and the sale of excess inventory at discounted prices could significantly impair our brand image and have a material adverse effect on our operating results and financial condition. Conversely, if we underestimate consumer demand for our products or if our manufacturers fail to supply the quality products that we require at the time we need them, we may experience inventory shortages. Inventory shortages might delay shipments to customers, negatively impact retailer and distributor relationships, and diminish brand loyalty.

**We Face Intense Competition, Including Competition From Companies With Significantly Greater Resources Than Ours, And If We Are Unable To Compete Effectively With These Companies, Our Market Share May Decline And Our Business Could Be Harmed.**

We face intense competition in the footwear industry from other established companies. A number of our competitors have significantly greater financial, technological, engineering, manufacturing, marketing and distribution resources than we do. Their greater capabilities in these areas may enable them to better withstand periodic downturns in the footwear industry, compete more effectively on the basis of price and production and more quickly develop new products. In addition, new companies may enter the markets in which we compete, further increasing competition in the footwear industry.

We believe that our ability to compete successfully depends on a number of factors, including the style and quality of our products and the strength of our brand name, as well as many factors beyond our control. We may not be able to compete successfully in the future, and increased competition may result in price reductions, reduced profit margins, loss of market share and an inability to generate cash flows that are sufficient to maintain or expand our development and marketing of new products, which would adversely impact the trading price of our Class A Common Stock.

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

During 2007, 2006 and 2005, our net sales to our five largest customers accounted for approximately 25.3%, 24.9%, and 25.4% of total net sales, respectively. No customer accounted for more than 10% of our net sales during 2007, 2006 and 2005. One customer accounted for 10.0% and 12.0% of net trade receivables at December 31, 2007 and December 31, 2006, respectively. Although we have long-term relationships with many of our customers, our customers do not have a contractual obligation to purchase our products and we cannot be certain that we will be able to retain our existing major customers. Furthermore, the retail industry regularly experiences consolidation, contractions and closings which may result in our loss of customers or our inability to collect accounts receivable of major customers. If we lose a major customer, experience a significant decrease in sales to a major customer or are unable to collect the accounts receivable of a major customer, our business could be harmed.

**We May Be Unable To Successfully Execute Our Growth Strategy Or Maintain Our Growth.**

Although our company has generally exhibited steady growth since we began operations, we had a decrease in net sales in the past and our rate of growth has declined at times as well, and we may experience similar decreases in net sales or declines in rate of growth again in the future. Our ability to grow in the future depends upon, among other things, the continued success of our efforts to maintain our brand image and expand our footwear offerings and distribution channels. As our business grows, we may need to improve and enhance our overall financial and managerial controls, reporting systems and procedures to effectively manage our growth. We may be unable to successfully implement our current growth strategy or other growth strategies or effectively manage our growth, any of which would negatively impact our business, results of operations and financial condition. Furthermore, in anticipation of continued increases in net sales, we have significantly expanded our infrastructure and workforce to achieve economies of scale. Because these expenses are mostly fixed in the short term, our operating results and margins will be adversely impacted if we do not continue to grow as anticipated.

**Our International Sales And Manufacturing Operations Are Subject To The Risks Of Doing Business Abroad, Particularly In China, Which Could Affect Our Ability To Sell Or Manufacture Our Products In International Markets, Obtain Products From Foreign Suppliers Or Control The Costs Of Our Products.**

Substantially all of our net sales during the year ended December 31, 2007 were derived from sales of footwear manufactured in foreign countries, with most manufactured in China and, to a lesser extent, in Italy, Vietnam and Brazil. We also sell our footwear in several foreign countries and plan to increase our international sales efforts as part of our growth strategy. Foreign manufacturing and sales are subject to a number of risks, including the following: political and social unrest, including the military presence in Iraq and terrorism; changing economic conditions, including higher labor costs; increased costs of raw materials; currency exchange rate fluctuations; labor shortages and work stoppages; electrical shortages; transportation delays; loss or damage to products in transit; expropriation; nationalization; the adjustment, elimination or imposition of domestic and international duties, tariffs, quotas, import



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and export controls and other non-tariff barriers; exposure to different legal standards (particularly with respect to intellectual property); compliance with foreign laws; and changes in domestic and foreign governmental policies. We have not, to date, been materially affected by any such risks, but we cannot predict the likelihood of such developments occurring or the resulting long-term adverse impact on our business, results of operations or financial condition.

In particular, because most of our products are manufactured in China, the possibility of adverse changes in trade or political relations with China, political instability in China, increases in labor costs, the occurrence of prolonged adverse weather conditions or a natural disaster such as an earthquake or typhoon in China, or the outbreak of a pandemic disease such as the Avian Flu in China could severely interfere with the manufacture and/or shipment of our products and would have a material adverse effect on our operations. In addition, electrical shortages, labor shortages or work stoppages may extend the production time necessary to produce our orders, and there may be circumstances in the future where we may have to incur premium freight charges to expedite the delivery of product to our customers. If we incur a significant amount of premium charges to airfreight product for our customers, our gross profit will be negatively affected if we are unable to collect those charges.

### **Currency Exchange Rate Fluctuations In China Could Result In Higher Costs And Decreased Margins.**

Our manufacturers located in China may be subject to the effects of exchange rate fluctuations should the Chinese currency not remain stable with the U.S. dollar. The value of the Chinese currency depends to a large extent on the Chinese government's policies and China's domestic and international economic and political developments. Since 1994, the official exchange rate for the conversion of the Chinese currency was pegged to the U.S. dollar at a virtually fixed rate of approximately 8.28 Yuan per U.S. dollar. However, on July 21, 2005, the Chinese government revalued the Yuan by 2.1%, setting the exchange rate at 8.11 Yuan per U.S. dollar, and adopted a more flexible system based on a trade-weighted basket of foreign currencies of China's main trading partners. Under the new managed float policy, the exchange rate of the Yuan may shift each day up to 0.3% in either direction from the previous day's close, and as a result, the exchange rate measured 7.29 Yuan per U.S. dollar at December 31, 2007. The valuation of the Yuan may continue to increase incrementally over time should the China central bank allow it to do so, which could significantly increase labor and other costs incurred in the production of our footwear in China, resulting in an adverse effect on our results of operations and financial condition.

### **The Potential Imposition Of Additional Duties, Quotas, Tariffs And Other Trade Restrictions Could Have An Adverse Impact On Our Sales And Profitability.**

All of our products manufactured overseas and imported into the United States, the European Union ( EU ) and other countries are subject to customs duties collected by customs authorities. Customs information submitted by us is routinely subject to review by customs authorities. We are unable to predict whether additional customs duties, quotas, tariffs, anti-dumping duties, safeguard measures, cargo restrictions to prevent terrorism or other trade restrictions may be imposed on the importation of our products in the future. Such actions could result in increases in the cost of our products generally and might adversely affect the sales and profitability of Skechers and the imported footwear industry as a whole.

### **Our Quarterly Revenues And Operating Results Fluctuate As A Result Of A Variety Of Factors, Including Seasonal Fluctuations In Demand For Footwear, Delivery Date Delays And Potential Fluctuations In Our Annualized Tax Rate, Which May Result In Volatility Of Our Stock Price.**

Our quarterly revenues and operating results have varied significantly in the past and can be expected to fluctuate in the future due to a number of factors, many of which are beyond our control. Our major customers generally have no obligation to purchase forecasted amounts and may cancel orders, change delivery schedules or change the mix of products ordered with minimal notice and without penalty. As a result, we may not be able to accurately predict our quarterly sales. In addition, sales of footwear products have historically been somewhat seasonal in nature with the strongest sales generally occurring in our second and third quarters for the back-to-school selling season. Back-to-school sales typically ship in June, July and August, and delays in the timing, cancellation, or rescheduling of these customer orders and shipments by our wholesale customers could negatively impact our net sales and results of operations for our second or third quarters. More specifically, the timing of when products are shipped is determined by the delivery schedules set by our wholesale customers, which could cause sales to shift between our second and

third quarters. Because our expense levels are partially based on our expectations of future net sales, our expenses may be disproportionately large relative to our revenues, and we may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shifts, which could have a material adverse effect on our operating results.

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Our annualized tax rate is based on projections of our domestic and international operating results for the year, which we review and revise as necessary at the end of each quarter, and it is highly sensitive to fluctuations in projected international earnings. Any quarterly fluctuations in our annualized tax rate that may occur could have a material impact on our quarterly operating results. As a result of these specific and other general factors, our operating results will likely vary from quarter to quarter and the results for any particular quarter may not be necessarily indicative of results for the full year. Any shortfall in revenues or net income from levels expected by securities analysts and investors could cause a decrease in the trading price of our Class A Common Stock.

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

Our footwear products are currently manufactured by independent contract manufacturers. During 2007 and 2006, the top four manufacturers of our products produced approximately 58.4% and 59.6% of our total purchases, respectively. One manufacturer accounted for 29.7% and 30.8% of total purchases during 2007 and 2006, respectively. Two other manufacturers each accounted for over 10.0% of our total purchases during 2007 and 2006. We do not have long-term contracts with our manufacturers, and we compete with other footwear companies for production facilities. We could experience difficulties with these manufacturers, including reductions in the availability of production capacity, failure to meet our quality control standards, failure to meet production deadlines or increased manufacturing costs. In particular, manufacturers in China are facing a labor shortage as migrant workers seek better wages and working conditions in farming and other vocations, and if this trend continues, our current manufacturers' operations could be adversely affected.

If our current manufacturers cease doing business with us, we could experience an interruption in the manufacture of our products. Although we believe that we could find alternative manufacturers, we may be unable to establish relationships with alternative manufacturers that will be as favorable as the relationships we have now. For example, new manufacturers may have higher prices, less favorable payment terms, lower manufacturing capacity, lower quality standards or higher lead times for delivery. If we are unable to provide products consistent with our standards or the manufacture of our footwear is delayed or becomes more expensive, this could result in our customers canceling orders, refusing to accept deliveries or demanding reductions in purchase prices, any of which could have a material adverse effect on our business and results of operations.

### **Our Business Could Be Harmed If Our Contract Manufacturers, Suppliers Or Licensees Violate Labor, Trade Or Other Laws.**

We require our independent contract manufacturers, suppliers and licensees to operate in compliance with applicable laws and regulations. Manufacturers are required to certify that neither convicted, forced or indentured labor (as defined under United States law) nor child labor (as defined by law in the manufacturer's country) is used in the production process, that compensation is paid in accordance with local law and that their factories are in compliance with local safety regulations. Although we promote ethical business practices and our sourcing personnel periodically visit and monitor the operations of our independent contract manufacturers, suppliers and licensees, we do not control them or their labor practices. If one of our independent contract manufacturers, suppliers or licensees violates labor or other laws or diverges from those labor practices generally accepted as ethical in the United States, it could result in adverse publicity for us, damage our reputation in the United States or render our conduct of business in a particular foreign country undesirable or impractical, any of which could harm our business.

In addition, if we, or our foreign manufacturers, violate United States or foreign trade laws or regulations, we may be subject to extra duties, significant monetary penalties, the seizure and the forfeiture of the products we are attempting to import or the loss of our import privileges. Possible violations of United States or foreign laws or regulations could include inadequate record keeping of our imported products, misstatements or errors as to the origin, quota category, classification, marketing or valuation of our imported products, fraudulent visas or labor violations. The effects of these factors could render our conduct of business in a particular country undesirable or impractical and have a negative impact on our operating results.

### **Our Operating Results Could Be Negatively Impacted If Our Sales Are Concentrated In Any One Style Or Group Of Styles.**

If any one style or group of similar styles of our footwear were to represent a substantial portion of our net sales, we could be exposed to risk should consumer demand for such style or group of styles decrease in subsequent periods. We attempt to mitigate this risk by offering a broad range of products, and no style comprised over 5% of our gross wholesale sales during 2007 or 2006. However, this may change in the future and fluctuations in sales of any given style that represents a significant portion of our future net sales could have a negative impact on our operating results.

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**Our Strategies Involve A Number Of Risks That Could Prevent Or Delay Any Successful Opening Of New Stores As Well As Impact The Performance Of Our Existing Stores.**

Our ability to open and operate new stores successfully depends on many factors, including, among others, our ability to identify suitable store locations, the availability of which is outside of our control; negotiate acceptable lease terms, including desired tenant improvement allowances; source sufficient levels of inventory to meet the needs of new stores; hire, train and retain store personnel; successfully integrate new stores into our existing operations; and satisfy the fashion preferences in new geographic areas.

In addition, some or a substantial number of new stores could be opened in regions of the United States in which we currently have few or no stores. Any expansion into new markets may present competitive, merchandising and distribution challenges that are different from those currently encountered in our existing markets. Any of these challenges could adversely affect our business and results of operations. In addition, to the extent that any new store openings are in existing markets, we may experience reduced net sales volumes in existing stores in those markets.

**Many Of Our Retail Stores Depend Heavily On The Customer Traffic Generated By Shopping And Factory Outlet Malls Or By Tourism.**

Many of our concept stores are located in shopping malls and some of our factory outlet stores are located in manufacturers' outlet malls where we depend on obtaining prominent locations and the overall success of the malls to generate customer traffic. We cannot control the development of new malls, the availability or cost of appropriate locations within existing or new malls or the success of individual malls. Some of our concept stores occupy street locations that are heavily dependent on customer traffic generated by tourism. Any substantial decrease in tourism resulting from political, social or military events, a downturn in the economy or otherwise, is likely to adversely affect sales in our existing stores, particularly those with street locations. The effects of these factors could hinder our ability to open retail stores in new markets or reduce sales of particular existing stores, which could negatively affect our operating results.

**We Depend On Key Personnel To Manage Our Business Effectively In A Rapidly Changing Market, And If We Are Unable To Retain Existing Personnel, Our Business Could Be Harmed.**

Our future success depends upon the continued services of Robert Greenberg, Chairman of the Board and Chief Executive Officer, Michael Greenberg, President, and David Weinberg, Executive Vice President and Chief Operating Officer. The loss of the services of any of these individuals or any other key employee could harm us. Our future success also depends on our ability to identify, attract and retain additional qualified personnel. Competition for employees in our industry is intense and we may not be successful in attracting and retaining such personnel.

**The Disruption, Expense And Potential Liability Associated With Existing And Unanticipated Future Litigation Against Us Could Have A Material Adverse Effect On Our Business, Results Of Operations And Financial Condition.**

We are subject to various legal proceedings and threatened legal proceedings from time to time as part of our business. We are not currently a party to any legal proceedings or aware of any threatened legal proceedings, the adverse outcome of which, individually or in the aggregate, we believe would have a material adverse effect on our business, results of operations or financial condition. However, any unanticipated litigation in the future, regardless of its merits, could significantly divert management's attention from our operations and result in substantial legal fees to us. Further, there can be no assurance that any actions that have been or will be brought against us will be resolved in our favor or, if significant monetary judgments are rendered against us, that we will have the ability to pay such judgments. Such disruptions, legal fees and any losses resulting from these claims could have a material adverse effect on our business, results of operations and financial condition.

**Our Ability To Compete Could Be Jeopardized If We Are Unable To Protect Our Intellectual Property Rights Or If We Are Sued For Intellectual Property Infringement.**

We believe that our trademarks, design patents and other proprietary rights are important to our success and our competitive position. We use trademarks on nearly all of our products and believe that having distinctive marks that are readily identifiable is an important factor in creating a market for our goods, in identifying us and in distinguishing our goods from the goods of others. We consider our Skechers®, S in Shield Design® and Performance-S Shifted Design® trademarks to be among our most valuable assets, and we have registered these trademarks in many

countries. In addition, we own many other trademarks that we utilize in marketing our products. We also have a number of design patents and a limited number of utility patents covering components and features used

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in various shoes. We believe that our patents and trademarks are generally sufficient to permit us to carry on our business as presently conducted. While we vigorously protect our trademarks against infringement, we cannot assure you that we will be able to secure patents or trademark protection for our intellectual property in the future or that protection will be adequate for future products. Further, we have been sued for patent and trademark infringement and cannot be sure that our activities do not and will not infringe on the intellectual property rights of others. If we are compelled to prosecute infringing parties, defend our intellectual property or defend ourselves from intellectual property claims made by others, we may face significant expenses and liability as well as the diversion of management's attention from our business, each of which could negatively impact our business or financial condition.

In addition, the laws of foreign countries where we source and distribute our products may not protect intellectual property rights to the same extent as do the laws of the United States. We cannot assure you that the actions we have taken to establish and protect our trademarks and other intellectual property rights outside the United States will be adequate to prevent imitation of our products by others or, if necessary, successfully challenge another party's counterfeit products or products that otherwise infringe on our intellectual property rights on the basis of trademark or patent infringement. Continued sales of these products could adversely affect our sales and our brand and result in the shift of consumer preference away from our products. We may face significant expenses and liability in connection with the protection of our intellectual property rights outside the United States, and if we are unable to successfully protect our rights or resolve intellectual property conflicts with others, our business or financial condition could be adversely affected.

### **Natural Disasters Or A Decline In Economic Conditions In California Could Increase Our Operating Expenses Or Adversely Affect Our Sales Revenue.**

A substantial portion of our operations are located in California, including 46 of our retail stores, our headquarters in Manhattan Beach, our current domestic distribution center in Ontario and our future domestic distribution center in Moreno Valley. Because a significant portion of our net sales is derived from sales in California, a decline in the economic conditions in California, whether or not such decline spreads beyond California, could materially adversely affect our business. Furthermore, a natural disaster or other catastrophic event, such as an earthquake or wild fires affecting California, could significantly disrupt our business including the operation of our only domestic distribution center. We may be more susceptible to these issues than our competitors whose operations are not as concentrated in California.

### **One Principal Stockholder Is Able To Control Substantially All Matters Requiring A Vote Of Our Stockholders And His Interests May Differ From The Interests Of Our Other Stockholders.**

As of December 31, 2007, Robert Greenberg, Chairman of the Board and Chief Executive Officer, beneficially owned 78.1% of our outstanding Class B Common Stock and members of Mr. Greenberg's immediate family beneficially owned the remainder of our outstanding Class B Common Stock. The holders of Class A Common Stock and Class B Common Stock have identical rights except that holders of Class A Common Stock are entitled to one vote per share while holders of Class B Common Stock are entitled to ten votes per share on all matters submitted to a vote of our stockholders. As a result, as of December 31, 2007, Mr. Greenberg beneficially owned approximately 62.1% of the aggregate number of votes eligible to be cast by our stockholders, and together with shares beneficially owned by other members of his immediate family, he beneficially owned approximately 79.6% of the aggregate number of votes eligible to be cast by our stockholders. Mr. Greenberg may have different interests than our other stockholders, and because he is able to control substantially all matters requiring approval by our stockholders, he may direct the operations of our business in a manner contrary to the interests of our other stockholders. Matters that require the approval of our stockholders include the election of directors and the approval of mergers or other business combination transactions. Mr. Greenberg also has control over our management and affairs. As a result of such control, certain transactions are not possible without the approval of Mr. Greenberg, including proxy contests, tender offers, open market purchase programs or other transactions that can give our stockholders the opportunity to realize a premium over the then-prevailing market prices for their shares of our Class A Common Stock. The differential in the voting rights may adversely affect the value of our Class A Common Stock to the extent that investors or any potential future purchaser view the superior voting rights of our Class B Common Stock to have value.

**Our Charter Documents And Delaware Law May Inhibit A Takeover, Which May Cause A Decline In The Value Of Our Stock.**

Provisions of Delaware law, our certificate of incorporation or our bylaws could make it more difficult for a third party to acquire us, even if closing such a transaction would be beneficial to our stockholders. Mr. Greenberg's substantial beneficial ownership position, together with the authorization of Preferred Stock, the disparate voting rights between our Class A Common Stock and Class B Common Stock, the classification of our Board of Directors and the lack of cumulative voting in our certificate of incorporation and



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bylaws, may have the effect of delaying, deferring or preventing a change in control, may discourage bids for our Class A Common Stock at a premium over the market price of the Class A Common Stock and may adversely affect the market price of our Class A Common Stock.

### **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

### **ITEM 2. PROPERTIES**

Our corporate headquarters and additional administrative offices are located at four premises in Manhattan Beach, California, which consist of an aggregate of approximately 100,000 square feet. We own and lease portions of our corporate headquarters and administrative offices. The property leases expire between October 2010 and February 2012, with options to extend these leases in some cases, and the current aggregate annual rent for the leased property is approximately \$0.5 million. Also, construction commenced in 2005 on another corporate facility in Manhattan Beach, California that is expected to be approximately 55,000 square feet. The exterior of the facility was completed in 2007, and we are currently working on the interior improvements and we expect to move in during 2008.

Our U.S. distribution center consists of four leased facilities and one that we own, which are located in Ontario, California. The four leased facilities aggregate approximately 1,407,000 square feet, with an annual base rent of approximately \$5.3 million. The owned distribution facility is approximately 264,000 square feet. The property leases expire between May 2009 and May 2011, and these leases contain rent escalation provisions. During 2007, we entered into a lease to build a new approximately 1.8 million square foot distribution facility in Moreno Valley, California. Once completed, we will occupy the facility under an eleven-year lease with one option to extend the lease four years followed by two options to extend the lease by additional five-year terms, and we will move out of our existing distribution facilities in Ontario, California. Base rent for the new facility will be \$679,540 per month for month 1 through month 60 and \$788,267 per month for month 61 through month 132.

Our European distribution center consists of a 240,000 square-foot facility in Liege, Belgium under a 25-year operating lease with base rent of approximately \$1.3 million per year. The lease provides for first right of refusal on three facilities planned for development, allowing for expansion up to a total of approximately 735,000 square feet. We believe that the capacity available to us within our lease agreement should allow for further growth of our international operations. The lease agreement also provides for early termination rights at five-year intervals beginning in February 2007, pending notification as prescribed in the lease, of which the first such right was not exercised.

All of our domestic retail stores and showrooms are leased with terms expiring between February 2008 and January 2019. The leases provide for rent escalations tied to either increases in the lessor's operating expenses, fluctuations in the consumer price index in the relevant geographical area or a percentage of the store's gross sales in excess of the base annual rent. Total base rent expense related to our domestic retail stores and showrooms was \$24.9 million for the year ended December 31, 2007.

We also lease all of our international administrative offices, retail stores and showrooms located in Brazil, Malaysia, Thailand, Canada, Switzerland, United Kingdom, Germany, France, Spain, Italy, and Netherlands. The property leases expire at various dates between February 2008 and September 2018. Total rent for the leased properties aggregated approximately \$7.4 million for the year ended December 31, 2007.

### **ITEM 3. LEGAL PROCEEDINGS**

See note 13 to the financial statements on page 56 of this annual report for a discussion of legal proceedings as required under applicable SEC disclosure rules and regulations.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to our security holders to be voted on during the fourth quarter of 2007.

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our Class A Common Stock trades on the New York Stock Exchange under the symbol SKX. The following table sets forth, for the periods indicated, the high and low sales prices of our Class A Common Stock.

|                                     | <b>HIGH</b> | <b>LOW</b> |
|-------------------------------------|-------------|------------|
| <b>YEAR ENDED DECEMBER 31, 2007</b> |             |            |
| First Quarter                       | \$38.03     | \$31.95    |
| Second Quarter                      | 36.87       | 28.41      |
| Third Quarter                       | 30.44       | 17.36      |
| Fourth Quarter                      | 25.57       | 18.75      |
| <b>YEAR ENDED DECEMBER 31, 2006</b> |             |            |
| First Quarter                       | \$25.04     | \$14.80    |
| Second Quarter                      | 28.35       | 21.19      |
| Third Quarter                       | 26.00       | 19.70      |
| Fourth Quarter                      | 33.58       | 23.51      |

**HOLDERS**

As of February 1, 2008, there were 101 holders of record of our Class A Common Stock (including holders who are nominees for an undetermined number of beneficial owners) and 16 holders of record of our Class B Common Stock. These figures do not include beneficial owners who hold shares in nominee name. The Class B Common Stock is not publicly traded but each share is convertible upon request of the holder into one share of Class A Common Stock.

**DIVIDEND POLICY**

Since our conversion from an S Corporation to a C Corporation prior to the initial public offering of our Class A Common Stock in 1999, earnings have been and will be retained for the foreseeable future in the operations of our business. We have not declared or paid any cash dividends on our Class A Common Stock and do not anticipate paying any cash dividends in the foreseeable future. Our current policy is to retain all of our earnings to finance the growth and development of our business.

**EQUITY COMPENSATION PLAN INFORMATION**

Our equity compensation plan information is provided as set forth in Part III, Item 12 of this annual report.

**Table of Contents****PERFORMANCE GRAPH**

The following graph demonstrates the total return to stockholders of our company's Class A Common Stock from December 31, 2002 to December 31, 2007, relative to the performance of the Russell 2000 Index, which includes our Class A Common Stock, and our peer group index, which consists of seven companies believed to be engaged in similar businesses: Nike, Inc., adidas AG, K-Swiss Inc., Kenneth Cole Productions, Inc., Steven Madden, Ltd., The Timberland Company and Wolverine World Wide, Inc. The Stride Rite Corporation was removed from the peer group index because its stock is no longer actively traded after being acquired by Payless ShoeSource, Inc. in August 2007.

The graph assumes an investment of \$100 on December 31, 2002 in each of our company's Class A Common Stock and the stocks comprising each of the Russell 2000 Index and the customized peer group index. Each of the indices assumes that all dividends were reinvested. The stock performance of our company's Class A Common Stock shown on the graph is not necessarily indicative of future performance. We will not make nor endorse any predictions as to our future stock performance.

| Company/Index         | 12/31/02  | 12/31/03 | 12/31/04 | 12/31/05 | 12/31/06 | 12/31/07 |
|-----------------------|-----------|----------|----------|----------|----------|----------|
| Skechers U.S.A., Inc. | \$ 100.00 | \$ 96.00 | \$152.65 | \$180.45 | \$392.34 | \$229.80 |
| Russell 2000          | 100.00    | 147.25   | 174.24   | 182.18   | 215.64   | 212.26   |
| Custom Peer Group     | 100.00    | 153.96   | 203.47   | 202.10   | 227.13   | 288.77   |

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA**

The following tables set forth our company's selected consolidated financial data as of and for each of the years in the five-year period ended December 31, 2007 and should be read in conjunction with our audited consolidated financial statements and notes thereto included under Part II, Item 8 of this annual report.

(In thousands, except net earnings (loss) per share)

| <b>STATEMENT OF EARNINGS DATA:</b>      | <b>YEARS ENDED DECEMBER 31,</b> |             |             |             |             |
|-----------------------------------------|---------------------------------|-------------|-------------|-------------|-------------|
|                                         | <b>2007</b>                     | <b>2006</b> | <b>2005</b> | <b>2004</b> | <b>2003</b> |
| Net sales                               | \$1,394,181                     | \$1,205,368 | \$1,006,477 | \$920,322   | \$834,976   |
| Gross profit                            | 599,989                         | 523,346     | 420,482     | 370,857     | 317,686     |
| Earnings (loss) from operations         | 112,930                         | 112,544     | 76,296      | 49,245      | (1,347)     |
| Earnings (loss) before income taxes     | 118,305                         | 112,648     | 72,797      | 38,720      | (10,373)    |
| Net earnings (loss)                     | 75,686                          | 70,994      | 44,717      | 23,553      | (11,867)    |
| Net earnings (loss) per share:(1) Basic | 1.67                            | 1.73        | 1.13        | 0.61        | (0.31)      |
| Diluted                                 | 1.63                            | 1.59        | 1.06        | 0.59        | (0.31)      |
| Weighted average shares:(1) Basic       | 45,262                          | 41,079      | 39,686      | 38,638      | 37,840      |
| Diluted                                 | 46,741                          | 46,139      | 44,518      | 39,800      | 37,840      |

| <b>BALANCE SHEET DATA:</b>                | <b>AS OF DECEMBER 31,</b> |             |             |             |             |
|-------------------------------------------|---------------------------|-------------|-------------|-------------|-------------|
|                                           | <b>2007</b>               | <b>2006</b> | <b>2005</b> | <b>2004</b> | <b>2003</b> |
| Working capital                           | \$523,888                 | \$450,787   | \$361,210   | \$313,883   | \$275,124   |
| Total assets                              | 827,977                   | 737,053     | 581,957     | 518,653     | 466,533     |
| Long-term debt, excluding current portion | 16,462                    | 106,805     | 107,288     | 113,038     | 116,047     |
| Stockholders' equity                      | 626,663                   | 449,087     | 343,830     | 294,895     | 255,654     |

(1) Basic earnings (loss) per share represents net earnings (loss) divided by the weighted-average number of common shares outstanding for the period. Diluted earnings (loss) per share, in addition to the weighted average determined for basic earnings per share, reflects the potential dilution that could occur if options to issue common stock were exercised or

converted into  
common stock  
and assumes the  
conversion of our  
4.50% convertible  
subordinated  
notes for the  
period  
outstanding since  
their issuance in  
April 2002 until  
their conversion  
in February 2007,  
unless their  
inclusion would  
be anti-dilutive.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION**

**GENERAL**

We design, market and sell contemporary footwear for men, women and children under the Skechers brand as well as eight other fashion and street brands. Our footwear is sold through a wide range of department stores and leading specialty retail stores, mid-tier retailers, boutiques, our own retail stores, distributor-owned international retail stores and our e-commerce website. Our objective is to continue to profitably grow our domestic operations while leveraging our brand name to expand internationally.

Our operations are organized along our distribution channels, and we have the following four reportable sales segments—domestic wholesale sales, international wholesale sales, retail sales and e-commerce sales. We evaluate segment performance based primarily on net sales and gross margins. See detailed segment information in note 14 to our consolidated financial statements included under Part II, Item 8 of this annual report.

**FINANCIAL OVERVIEW**

Skechers achieved record revenue during 2007. Our net sales for 2007 were \$1.394 billion, an increase of \$188.8 million or 15.7% percent over net sales of \$1.205 billion in 2006. Diluted earnings per share were \$1.63, which reflected a 2.5% increase over the \$1.59 reported in the prior year. Working capital was \$523.9 million at December 31, 2007, an increase of \$73.1 million from working capital of \$450.8 million at December 31, 2006. Cash and short-term investments increased by \$83.5 million to \$304.0 million in 2007 compared to \$220.5 million at December 31, 2006, primarily due to our 2007 earnings.

Our domestic wholesale segment is our largest distribution channel comprising 59.6%, 64.1%, and 63.0% of our consolidated net sales for the years ended December 31, 2007, 2006 and 2005, respectively. Our international wholesale sales comprised 19.2%, 15.2%, and 16.3% of our consolidated net sales for the years ended December 31, 2007, 2006 and 2005, respectively. Retail sales comprised 20.0%, 19.7%, and 20.0% of our consolidated net sales for the years ended December 31, 2007, 2006 and 2005, respectively, of which our domestic retail sales comprised 18.3%, 18.1%, and 18.4% of our consolidated net sales for the years ended December 31, 2007, 2006 and 2005, respectively. Our international retail sales did not comprise more than 10% of our consolidated net sales in 2007, 2006 or 2005.

Domestic wholesale unit sales volume increased 8.7% to 43.2 million pairs in 2007 from 39.8 million pairs in 2006, and our average selling price per pair decreased 1.2% to \$19.22 in 2007 from \$19.44 in 2006. The decrease in average selling price per pair and increase in unit sales volume were primarily due to the introduction of our Cali Gear line.

**2007 INITIATIVES**

Our positive results for 2007 were driven by focusing on our core strengths and initiatives for the year, which included:

**New product design and delivery.** Our success depends on our ability to frequently introduce new styles and product lines as well as to design products in anticipation of consumers' ever-evolving preferences. This includes building our existing product lines with updates to proven sellers as well as creating new styles that we believe will become core to these lines in upcoming seasons. In 2007, we focused primarily on key sellers in our current divisions, launching our Cali Gear line and eliminating underperforming brands. During 2007, we discontinued three of our fashion lines—Michelle K, Avirex and Kitson footwear.

**Building our brands.** As a marketing-driven company, we consistently focus on advertising our brands in targeted publications, on key television programming and in high traffic areas in better malls. During 2007, we increased our exposure on TV with more campaigns targeted to men, women and children for Skechers and our fashion brands. This included our first animated spot for Airators by Skechers. We also utilized the power of celebrities for Skechers and several of our fashion lines.

**Develop our infrastructure to support continued growth.** During 2007, we entered into a lease agreement to build a new approximately 1.8 million square foot distribution facility to consolidate all of our domestic distribution facilities into one location. Once this new facility is built, we will move out of our five existing distribution facilities in Ontario, California.



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**Further grow our company-owned retail business.** With a focus on profitably growing our retail business, we increased our store count by 39 stores in 2007, and we saw single digit comparable store sales growth in our domestic retail business during 2007 despite a challenging retail environment.

**Further develop our international businesses.** In 2007, we continued to focus on improving our international operations by (i) increasing our customer base within our existing subsidiary business; (ii) increasing the product count within each account; (iii) delivering the right product into the right markets; (iv) launching the Marc Ecko and Zoo York branded lines in select global markets, including through our European subsidiaries and (v) establishing new opportunities for growth by entering new markets and growing in existing markets. We also increased our direct selling effort by opening subsidiaries in Brazil, Malaysia and Thailand as well as increasing our distributor network into Scandinavia and the Ukraine.

### OUTLOOK FOR 2008

We will continue to focus our product offering in 2008 with new products, such as our Cali Gear line, which do not directly compete with our existing brands and allow us the opportunity to broaden the targeted demographic profile of our consumer base, increase our shelf space and open new doors without detracting from existing business. In addition, we will continue to grow our international business with the goal of increasing that business to 25% to 30% of our total business. We are also seeking to increase our global presence through a joint venture agreement in China. We will also continue to expand our retail distribution channel by opening another 25 to 30 company-owned stores in 2008.

### YEAR ENDED DECEMBER 31, 2007 COMPARED TO THE YEAR ENDED DECEMBER 31, 2006

#### *Net sales*

Net sales for 2007 were \$1.394 billion, an increase of \$188.8 million, or 15.7%, over net sales of \$1.205 billion in 2006. The increase in net sales was due to increased international wholesale sales, domestic wholesale sales, and retail sales primarily due to acceptance of new designs and styles for our in-season product including sport fusion, casual fusion footwear and the introduction of our Cali Gear footwear. The increase in net sales was also due growth within the domestic retail segment from an increased store base as well as positive domestic and international comparative store sales increases (*i.e.*, stores open for at least one year).

Our domestic wholesale segment increased 7.5%, or \$58.3 million, to \$831.2 million compared to \$772.9 million in 2006. The increase in domestic wholesale segment net sales came on an 8.7% unit sales volume increase to 43.2 million pairs from 39.8 million pairs in 2006. The strongest increases in domestic wholesale came in our Women's Active, Men's USA, and Kids lines, along with the introduction of our Cali Gear line. Our average selling price per pair decreased 1.2% to \$19.22 from \$19.44 in 2006.

Our international wholesale segment sales increased \$83.9 million to \$267.6 million in 2007, a 45.7% increase over sales of \$183.7 million in 2006. Our international wholesale sales consist of direct subsidiary sales—those we make to department stores and specialty retailers—and sales to our distributors who in turn sell to department stores and specialty retailers in various international regions where we do not sell direct. Direct subsidiary sales increased \$49.9 million, or 53.1%, to \$144.0 million compared to net sales of \$94.1 million in 2006. The increase in direct subsidiary sales was primarily due to increased sales into UK, Canada, Benelux, and Germany. Our distributor sales increased \$34.0 million to \$123.6 million in 2007, a 37.9% increase over sales of \$89.6 million in 2006. This was primarily due to increased sales to our distributors in Russia, Panama, Serbia and Japan.

Our retail segment sales increased \$42.0 million to \$279.4 million in 2007, a 17.7% increase over sales of \$237.4 million in 2006. The increase in retail sales was due to a net increase of 36 domestic stores, increased sales across all three store formats and positive comparable store sales. During 2007, we opened 42 new stores and closed three stores. These new stores contributed \$16.9 million in net sales during 2007 as compared to new store sales of \$10.0 million for 22 other stores opened in 2006. Of our new store additions, 28 were concept stores, 11 were outlet stores, and three were warehouse stores. In addition, during 2007, we realized positive comparable store sales increases in our domestic retail stores of 5.1% and 16.7% in our international retail stores. Our domestic retail sales increased 17.5% due to positive comparable sales and having 22 retail stores that were opened in 2006 being open the entire year in 2007. Our international retail sales increased 20.2% in 2007 compared to 2006, due to increased comparable sales, the opening of three additional stores, as well as favorable currency translation adjustments.



We had 177 domestic retail stores as of February 15, 2008, and we believe that we have a presence in most major domestic markets. We currently plan to open approximately 25 to 30 domestic retail stores in 2008. During 2007, we closed two under-performing domestic retail stores, while we closed three in 2006. We periodically review all of our stores for impairment. During

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2007 and 2006, we did not record an impairment charge. Further, we carefully review our under-performing stores and may consider the non-renewal of leases upon completion of the current term of the applicable lease.

Our e-commerce sales increased \$4.5 million to \$15.9 million in 2007, a 40.2% increase over sales of \$11.4 million in 2006. Our e-commerce sales made up 1% of our consolidated net sales in both 2007 and 2006.

### ***Gross profit***

Gross profit for 2007 increased \$76.7 million to \$600.0 million as compared to \$523.3 million in 2006. Gross profit as a percentage of net sales, or gross margin, decreased to 43.0% in 2007 from 43.4% in 2006. This gross margin decrease was the result of the decrease in domestic wholesale margins and a decrease in retail margins to 61.5% in 2007 from 63.8% in 2006. This was partially offset by the increase in international wholesale margins, which increased to 37.3% in 2007 from 35.4% in 2006.

Our domestic wholesale segment increased \$19.2 million, or 6.4%, to \$320.4 million in 2006 compared to \$301.2 million in 2006. Domestic wholesale margins decreased to 38.5% in 2007 from 39.0% for 2006. The decrease in domestic wholesale margins was due to lower average selling prices related to the introduction of our Cali Gear line and lower margins from closing out our discontinued fashion brands.

Gross profit for our international wholesale segment increased \$34.8 million, or 53.4%, to \$99.8 million for 2007 compared to \$65.0 million in 2006. Gross margins were 37.3% for 2007 compared to 35.4% in 2006. Gross margins for our direct subsidiary sales were 45.0% in 2007 as compared to 42.4% in 2006. Gross margins for our distributor sales were 28.2% in 2007 as compared to 28.1% in 2006. The increase in gross margins for the international wholesale segment was due to increased subsidiary sales, which achieve higher gross margins than our international wholesale sales through our foreign distributors.

Gross profit for our retail segment increased \$20.4 million, or 13.4%, to \$171.8 million in 2007 as compared to \$151.4 million in 2006. This increase in gross profit was due to 22 stores that were opened in 2006 being open the entire year in 2007 and positive comparable store sales increases of 16.7% and 5.1% in our international and domestic stores, respectively. During 2007, we opened 38 new domestic stores, and closed two other domestic stores. Gross margins decreased to 61.5% in 2007 as compared to 63.8% in 2006. Again, the decrease in margins was due to lower average selling prices related to the introduction of our Cali Gear line and lower margins from closing out our discontinued fashion brands.

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

### ***Licensing***

Net licensing royalties increased \$0.1 million, or 1.6%, to \$4.2 million for 2007 compared to \$4.1 million in 2006.

### ***Selling expenses***

Selling expenses increased by \$16.6 million, or 15.1%, to \$126.5 million for 2007 from \$109.9 million in 2006. As a percentage of net sales, selling expenses were 9.1% in 2007 and 2006. The increase in selling expenses was primarily due to increased television and print advertising of \$14.5 million and increased promotional costs of \$2.4 million due to the launch of our Cali Gear line. Selling expenses consist primarily of the following: sales representative sample costs, sales commissions, trade shows, advertising and promotional costs, which may include television and ad production costs, and expenses associated with marketing materials.

### ***General and administrative expenses***

General and administrative expenses increased by \$59.7 million, or 19.6%, to \$364.7 million for 2007 from \$305.0 million in 2006. As a percentage of sales, general and administrative expenses were 26.2% and 25.3% in 2007 and 2006, respectively. The increase in general and administrative expenses was primarily due to increased salaries and wages of \$19.3 million, which includes stock compensation costs of \$1.1 million, higher rent expense of \$8.5 million due to the opening of 42 retail stores, and increased warehouse and distribution costs of \$8.2 million and increased temporary help of \$5.1 million due to increased sales and the addition



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of another domestic distribution facility. In addition, the expenses related to our distribution network, including the functions of purchasing, receiving, inspecting, allocating, warehousing and packaging of our products totaled \$97.6 million and \$77.6 million for 2007 and 2006, respectively. The \$20.0 million increase was due in part to the addition of our fifth domestic distribution facility in Ontario, California and its functional integration with the existing domestic distribution facility, as well as increased sales volume.

General and administrative expenses consist primarily of the following: salaries, wages and related taxes, various overhead costs associated with our corporate staff, stock-based compensation, domestic and international retail operations, non-selling related costs of our international operations, costs associated with our domestic and European distribution centers, professional fees related to both legal and accounting, insurance, and depreciation and amortization, asset impairment, amongst other expenses. Our distribution network related costs are included in general and administrative expenses and are not allocated to specific segments.

We believe that we have established our presence in most major domestic and international retail markets. We opened 38 domestic retail stores and four international retail stores in 2007, while closing two domestic stores and one international store. We currently plan to open between 25 and 30 domestic stores in 2008. In addition, we plan to continue to pursue opportunistic international retail store locations.

We continue to review our cost structure to develop efficiencies within our operations; however, we believe that our current cost structure is consistent with our anticipated sales levels in 2008.

### ***Interest income***

Interest income for 2007 increased \$1.6 million to \$10.0 million as compared to \$8.4 million for the same period in 2006. The increase in interest income resulted from higher average cash and investment balances during 2007 when compared to the same period in 2006 and interest received on a legal settlement in 2007. Interest income earned on our short-term investment balances was primarily tax exempt.

### ***Interest expense***

Interest expense for 2007 decreased \$4.4 million to \$4.8 million as compared to \$9.2 million for the same period in 2006. The decrease in interest expense was primarily due to the conversion of our 4.5% convertible subordinated notes to shares of our Class A common stock on or prior to February 20, 2007. Interest expense was incurred on mortgages on our distribution center and our corporate office located in Manhattan Beach, California, and amounts owed to our foreign manufacturers.

### ***Other income (expense)***

Other income, net for 2007 decreased \$0.9 million to \$0.1 million as compared to \$1.0 million for the same period in 2006. The decrease in other income was mainly due to foreign currency losses.

### ***Income taxes***

The effective tax rate for 2007 was 36.0% as compared to 37.0% in 2006. Income tax expense for 2007 was \$42.6 million compared to \$41.7 million for 2006. The tax provision was computed using the effective tax rates applicable to each of our domestic and international taxable jurisdictions. The 2007 rate is slightly lower than the expected domestic rate of approximately 40% due to our non-U.S. subsidiary earnings in lower tax rate jurisdictions and our reinvestment of undistributed earnings from our non-U.S. subsidiaries, thereby indefinitely postponing their remittance to the U.S. parent. As such, we did not provide for deferred income taxes on accumulated undistributed earnings of our non-U.S. subsidiaries. As of December 31, 2007, withholding and U.S. taxes have not been recorded on approximately \$15.5 million of cumulative undistributed earnings.

YEAR ENDED DECEMBER 31, 2006 COMPARED TO THE YEAR ENDED DECEMBER 31, 2005

### ***Net sales***

Net sales for 2006 were \$1.205 billion, an increase of \$198.9 million, or 19.8%, over net sales of \$1.006 billion in 2005. The increase in net sales was due to increased domestic wholesale sales, retail sales and international wholesale sales. The increase in sales was a result of increased demand for our in-season products and broader acceptance of our new lines, including sport fusion and casual fusion footwear.

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Our domestic wholesale segment increased 21.9%, or \$138.6 million, to \$772.9 million compared to \$634.3 million in 2005. The increase in domestic wholesale segment net sales came on a 15.6% unit sales volume increase to 39.8 million pairs from 34.4 million pairs in 2005. The strongest increases came in our Women's Active, Men's USA, and Kids lines. Our average selling price per pair increased 5.4% to \$19.44 from \$18.45 in 2005.

Our international wholesale segment sales increased \$20.2 million to \$183.7 million in 2006, a 12.3% increase over sales of \$163.5 million in 2005. Direct subsidiary sales increased \$10.7 million, or 12.8%, to \$94.1 million compared to net sales of \$83.4 million in 2005. The increase in direct subsidiary sales was primarily due to increased sales into UK, Germany, Benelux, and Canada. Our distributor sales increased \$9.5 million to \$89.6 million in 2006, an 11.8% increase over sales of \$80.1 million in 2005. This was primarily due to increased sales to our distributors in Panama, Russia and Serbia.

Our retail segment sales increased \$35.8 million to \$237.4 million in 2006, a 17.8% increase over sales of \$201.6 million in 2005. The increase in retail sales was due to a net increase of 20 stores, increased sales across all three store formats and positive comparable store sales. During 2006, we opened 22 new domestic stores and one international store, and we closed three other domestic stores. These new stores contributed \$10.0 million in net sales during 2006 as compared to new store sales of \$4.6 million for eleven other stores opened in 2005. Of our new store additions, 14 were concept stores, eight were outlet stores, and one was a warehouse store. In addition, during 2006, we realized positive comparable store sales increases in our domestic retail stores of 10.7% and 14.6% in our international retail stores. Our domestic retail sales increased 17.3% due to positive comparable sales and having seven retail stores that were opened in 2005 being open the entire year in 2006. Our international retail sales increased 22.6% in 2006 compared to 2005, due to increased comparable sales, the opening of one additional store, as well as favorable currency translation adjustments.

During 2006, we closed three under-performing retail stores, which was the same number closed in 2005. During 2006, we did not record an impairment charge. During 2005, we recorded an impairment charge of \$0.9 million related to leasehold improvements for two of our stores.

Our e-commerce sales increased \$4.4 million to \$11.4 million in 2006, a 61.3% increase over sales of \$7.0 million in 2005. Our e-commerce sales made up less than 1% of our consolidated net sales in both 2006 and 2005.

***Gross profit***

Gross profit for 2006 increased \$102.8 million to \$523.3 million as compared to \$420.5 million in 2005. Gross profit as a percentage of net sales, or gross margin, increased to 43.4% in 2006 from 41.8% in 2005. This gross margin increase was primarily the result of increased retail margins to 63.8% in 2006 from 61.5% in 2005. This was partially offset by the decrease in international wholesale margins, which decreased to 35.4% in 2006 from 37.2% in 2005. Increased margins were a result of increased sales volume in our higher margin in-season products and broader acceptance of our new lines, including sport fusion and casual fusion footwear.

Our domestic wholesale segment gross margin increased \$68.8 million, or 29.6%, to \$301.2 million in 2006 compared to \$232.4 million in 2005. Domestic wholesale margins increased to 39.0% in 2006 from 36.6% for 2005.

Gross profit for our international wholesale segment increased \$4.2 million, or 7.0%, to \$65.0 million for 2006 compared to \$60.8 million in 2005. Gross margins were 35.4% for 2006 compared to 37.2% in 2005. International wholesale sales through our foreign subsidiaries achieve higher gross margins than our international wholesale sales through our foreign distributors. Gross margins for our direct subsidiary sales were 42.4% in 2006 as compared to 44.0% in 2005. Gross margins for our distributor sales were 28.1% in 2006 as compared to 30.1% in 2005. The decrease in gross margins was primarily due to increased discounts and allowances.

Gross profit for our retail segment increased \$27.5 million, or 22.2%, to \$151.4 million in 2006 as compared to \$123.9 million in 2005. This increase in gross profit was due to eleven stores that were opened in 2005 being open the entire year in 2006 and positive comparable store sales increases of 14.6% and 10.7% in our international and domestic stores, respectively. During 2006, we opened 22 new domestic stores, one international store and closed three other domestic stores. Gross margins increased to 63.8% in 2006 as compared to 61.5% in 2005. Again, increased margins were a result of increased sales volume in our higher margin in-season products and broader acceptance of our new lines, including sport fusion and casual fusion footwear.



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### ***Licensing***

Net licensing royalties decreased \$2.5 million, or 37.9%, to \$4.1 million for 2006 as compared to \$6.6 million in 2005. The decrease in net licensing royalties is primarily the result of decreased royalty revenue associated with our various licensing agreements.

### ***Selling expenses***

Selling expenses increased by \$28.5 million, or 35.0%, to \$109.9 million for 2006 from \$81.4 million in 2005. As a percentage of net sales, selling expenses were 9.1% and 8.1% in 2006 and 2005, respectively. The increase in selling expenses was primarily due to increased media advertising expenses of \$22.1 million, increased sales commissions of \$3.4 million due to higher revenues, and higher trade show expenses of \$2.8 million.

### ***General and administrative expenses***

General and administrative expenses increased by \$35.6 million, or 13.2%, to \$305.0 million for 2006 from \$269.4 million in 2005. As a percentage of sales, general and administrative expenses were 25.3% and 26.8% in 2006 and 2005, respectively. The increase in general and administrative expenses was primarily due to increased salaries and wages of \$21.2 million, which includes stock compensation costs of \$2.0 million due to the adoption of SFAS 123(R) in January 2006, increased outside services of \$3.5 million, higher rent expense of \$3.2 million due to the opening of 23 retail stores, and increased warehouse and distribution costs of \$3.0 million resulting from increased sales. In addition, the expenses related to our distribution network, including the functions of purchasing, receiving, inspecting, allocating, warehousing and packaging of our products totaled \$77.6 million and \$70.5 million for 2006 and 2005, respectively. We did not record any impairment charges in 2006. In 2005, impairment charges of \$0.9 million related to the write-off of leasehold improvements at one of our domestic retail stores and one international retail store.

### ***Interest income***

Interest income for 2006 increased \$4.0 million to \$8.4 million as compared to \$4.4 million for the same period in 2005. The increase in interest income resulted from higher interest rates and higher average cash and investment balances during 2006 when compared to the same period in 2005.

### ***Interest expense***

Interest expense was \$9.2 million for both 2006 and 2005. Interest expense is incurred on our convertible notes, mortgages on our distribution center and our corporate office located in Manhattan Beach, California, our capital lease obligations, and interest on amounts owed to our foreign manufacturers.

### ***Other income (expense)***

Other income, net decreased \$0.3 million to \$1.0 million for 2006 as compared to \$1.3 million in 2005. The decrease in other income was mainly due to lower recoveries related to the settlement of various lawsuits during 2006 as compared to 2005, offset by foreign currency gains.

### ***Income taxes***

The effective tax rate for 2006 was 37.0% as compared to 38.6% in 2005. Income tax expense for 2006 was \$41.7 million compared to \$28.1 million for 2005. The tax provision was computed using the effective tax rates applicable to each of our domestic and international taxable jurisdictions. The 2006 rate is slightly lower than the expected domestic rate of approximately 40% due to our non-U.S. subsidiary earnings in lower tax rate jurisdictions and our reinvestment of undistributed earnings from our non-U.S. subsidiaries, thereby indefinitely postponing their remittance to the U.S. parent. As such, we did not provide for deferred income taxes on accumulated undistributed earnings of our non-U.S. subsidiaries. As of December 31, 2006, withholding and U.S. taxes have not been provided on approximately \$6.0 million of cumulative undistributed earnings.

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**LIQUIDITY AND CAPITAL RESOURCES**

Our working capital at December 31, 2007 was \$523.9 million, an increase of \$73.1 million from working capital of \$450.8 million at December 31, 2006. Our cash and cash equivalents at December 31, 2007 were \$199.5 million compared to \$160.5 million at December 31, 2006. The increase in cash and cash equivalents of \$39.0 million was the result of our cash flow from operations of \$101.4 million and proceeds of \$8.2 million from stock options exercised, which was offset by utilizing excess cash to purchase \$44.5 million of short-term investments and capital expenditures of \$31.2 million.

During 2007, our operating activities generated \$101.4 million in net cash compared to cash provided by operating activities of \$26.0 million for 2006. The significant increase in our operating cash flows for 2007, when compared to 2006, was mainly the result of our earnings and lower accounts receivable balances, which was partially offset by a smaller decrease in accounts payable in 2007 compared to 2006.

Net cash used in investing activities was \$75.7 million for 2007 as compared to \$87.6 million in 2006. During 2007, we purchased \$44.5 million in short-term investments to better utilize our cash balances. Capital expenditures for 2007 were approximately \$31.2 million, of which \$7.1 million related to the construction of our new corporate headquarters and the balance primarily consisted of new store openings and remodels. This was compared to capital expenditures of \$27.6 million in the prior year, which primarily consisted of new store openings and remodels and warehouse equipment upgrades. During 2005, we entered into a construction agreement with Morley Construction Company for the construction of our third owned corporate facility in Manhattan Beach, California. The agreement has a maximum payment clause in which Morley agreed that the construction cost of the facility will not exceed \$18.1 million plus change orders of \$1.7 million, of which \$19.2 million was incurred at December 31, 2007. The exterior of the facility was completed in 2007, and while we are currently working on the interior improvements, we expect to move in during 2008. Excluding the construction of our corporate headquarters and our new distribution center in Moreno Valley, California, we expect our ongoing capital expenditures for 2008 to be approximately \$25.0 million, which includes opening between 25 to 30 domestic retail stores and investments in information technology. We are currently in the process of designing and purchasing the equipment to be used in our new distribution center and estimate the cost of this equipment to be between \$75.0 million and \$85.0 million. We currently anticipate that our capital expenditure requirements will be funded through our operating cash flows, current cash and short-term investments on hand, or available lines of credit.

Net cash provided by financing activities was \$9.9 million during 2007 compared to net cash provided by financing activities of \$22.9 million during 2006. The decrease in cash provided by financing activities was due to lower proceeds from the issuance of Class A common stock upon the exercise of stock options during the year ended December 31, 2007 as compared to the prior year.

In April 2002, we issued \$90.0 million aggregate principal amount of 4.50% convertible subordinated notes due April 15, 2007. On January 19, 2007, we called these notes for redemption. The redemption date was February 20, 2007. The aggregate principal amount of notes outstanding was \$90.0 million. Holders of \$89.969 million principal amount of the notes converted their notes into shares of our Class A common stock prior to the redemption date, which included \$2.5 million of principal amount of the notes held by us. As a result of these conversions, 3,464,594 shares of Class A common stock were issued to holders of the notes, which included 96,272 shares issued to us that were immediately retired. In connection with these conversions, we paid approximately \$500 in cash to holders who elected to convert their notes, which represented cash paid in lieu of fractional shares. In addition, we paid approximately \$32,000 to holders who redeemed their notes, which represented the redemption price of 100.9% of \$31,000 principal amount of the notes plus accrued interest.

We have outstanding debt of \$16.9 million that primarily relates to notes payable for one of our distribution center warehouses and one of our administrative offices, which notes are secured by the respective properties.

On May 31, 2006, we amended our secured line of credit, which permits our company and certain of our subsidiaries to borrow up to \$150.0 million based upon eligible accounts receivable and inventory, which line of credit can be increased to \$250.0 million at our request. Borrowings bear interest at the borrowers' election based on either the prime rate or the London Interbank Offered Rate (LIBOR). Prime rate loans will bear interest at a rate equal to JPMorgan Chase Bank's publicly announced prime rate less up to 0.50%. LIBOR loans will bear interest at a rate equal



to the applicable LIBOR plus up to an additional 1.75%. We pay a monthly unused line of credit fee of 0.25% per annum. The loan agreement, which expires on May 31, 2011, provides for the issuance of letters of credit up to a maximum of \$30.0 million. The loan agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including a financial covenant requiring a fixed charge coverage ratio of not less than 1.1 at the end of each quarter if excess availability of eligible account receivable and inventory is less than \$50.0 million at any time during such quarter. Excess availability was not less than \$50.0 million during the year-ended December 31, 2007; hence, the fixed charge ratio

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requirement was not applicable at such date. No amounts were outstanding and we were in compliance with all other covenants of the loan agreement at December 31, 2007. We had \$9.6 million of outstanding letters of credit as December 31, 2007.

We believe that anticipated cash flows from operations, available borrowings under our secured line of credit, cash on hand, short-term investments and our financing arrangements will be sufficient to provide us with the liquidity necessary to fund our anticipated working capital and capital requirements through 2008. However, in connection with our current strategies, we will incur significant working capital requirements and capital expenditures. Our future capital requirements will depend on many factors, including, but not limited to, costs associated with moving to a new distribution facility, the levels at which we maintain inventory, the market acceptance of our footwear, the success of our international operations, the levels of promotion and advertising required to promote our footwear, the extent to which we invest in new product design and improvements to our existing product design, acquisition of other brands or companies, and the number and timing of new store openings. To the extent that available funds are insufficient to fund our future activities, we may need to raise additional funds through public or private financing of debt or equity. We cannot be assured that additional financing will be available or that, if available, it can be obtained on terms favorable to our stockholders and us. Failure to obtain such financing could delay or prevent our planned expansion, which could adversely affect our business, financial condition and results of operations. In addition, if additional capital is raised through the sale of additional equity or convertible securities, dilution to our stockholders could occur.

**DISCLOSURE ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS**

The following table aggregates all material contractual obligations and commercial commitments as of December 31, 2007:

|                                                           |            | <b>Payments Due by Period (In Thousands)</b> |                                   |                                    |                                         |
|-----------------------------------------------------------|------------|----------------------------------------------|-----------------------------------|------------------------------------|-----------------------------------------|
|                                                           |            | <b>Less than<br/>One<br/>Year</b>            | <b>One to<br/>Three<br/>Years</b> | <b>Three to<br/>Five<br/>Years</b> | <b>More<br/>Than<br/>Five<br/>Years</b> |
| Other long-term debt                                      | \$ 21,082  | \$ 1,783                                     | \$ 3,567                          | \$ 15,732                          |                                         |
| Operating lease obligations (1)                           | 411,576    | 47,124                                       | 106,339                           | 81,496                             | \$ 176,617                              |
| Purchase obligations (2)                                  | 239,523    | 239,523                                      |                                   |                                    |                                         |
| Construction contract (3)                                 | 663        | 663                                          |                                   |                                    |                                         |
| Minimum payments related to our<br>licensing arrangements | 41,110     | 10,055                                       | 15,655                            | 15,400                             |                                         |
|                                                           | \$ 713,954 | \$ 299,148                                   | \$ 125,561                        | \$ 112,628                         | \$ 176,617                              |

(1) Operating lease obligations consists primarily of real property leases for our retail stores, corporate offices and distribution centers. These leases frequently include options

that permit us to extend beyond the terms of the initial fixed term. Payments for these lease terms are provided for by cash flows generated from operations or, if needed, by our \$150.0 million secured line of credit, for which no amounts were outstanding at December 31, 2007.

- (2) Purchase obligations includes the following:
- (i) accounts payable balances for the purchase of footwear of \$81.3 million,
  - (ii) outstanding letters of credit of \$9.6 million and
  - (iii) open purchase commitments with our foreign manufacturers for \$148.7 million.
- We currently expect to fund these commitments with cash flows from operations and/or cash on hand.

(3)

During 2005, we entered into a construction agreement with Morley Construction Company for the construction of our third owned corporate facility in Manhattan Beach, California. The agreement has a maximum payment clause in which Morley agrees that the construction cost of the core and shell of the facility will not exceed \$18.1 million plus change orders of \$1.7 million, of which \$19.2 million was incurred at December 31, 2007. The exterior of the facility was completed in 2007, and we are currently working on the interior improvements and we expect to move in during 2008.

#### OFF-BALANCE SHEET ARRANGEMENTS

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

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**CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES**

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting estimates are affected by more significant judgments used in the preparation of our consolidated financial statements: revenue recognition, allowance for bad debts, returns, sales allowances and customer chargebacks, inventory write-downs, valuation of long-lived assets, litigation reserves, valuations of deferred income taxes, uncertain tax positions, foreign currency translation and stock-based compensation.

**Revenue Recognition.** We derive income from the sale of footwear and royalties earned from licensing the Skechers brand. Domestically, goods are shipped Free on Board ( FOB ) shipping point directly from our domestic distribution center in Ontario, California. For our European international wholesale customers, product is shipped FOB shipping point direct from our distribution center in Liege, Belgium. For our distributor sales, the goods are generally delivered directly from the independent factories to our distributors' freight forwarders on a Free Named Carrier ( FCA ) basis. We recognize revenue on wholesale sales when products are shipped and the customer takes title and assumes risk of loss, collection of relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. This generally occurs at time of shipment. Allowances for estimated returns, discounts, doubtful accounts and chargebacks are provided for when related revenue is recorded. Related costs paid to third-party shipping companies are recorded as a cost of sales. We recognize revenue from retail sales at the point of sale.

Royalty income is earned from our licensing arrangements. Upon signing a new licensing agreement, we receive up-front fees, which are generally characterized as prepaid royalties. These fees are initially deferred and recognized as revenue as earned (i.e., as licensed sales are reported to the company or on a straight line basis over the term of the agreement). The first calculated royalty payment is based on actual sales of the licensed product. Typically, at each quarter end we receive correspondence from our licensees indicating what the actual sales for the period were. This information is used to calculate and accrue the related royalties currently receivable based on the terms of the agreement.

**Allowance for bad debts, returns, sales allowances and customer chargebacks.** We provide a reserve against our receivables for estimated losses that may result from our customers' inability to pay. To minimize the likelihood of uncollectibility, customers' credit-worthiness is reviewed periodically based on external credit reporting services and our experience with the account, and it is adjusted accordingly. When a customer's account becomes past due, we generally place a hold on the account and discontinue further shipments to that customer, minimizing further risk of loss. We determine the amount of the reserve by analyzing known uncollectible accounts, aged receivables, economic conditions in the customers' country or industry, historical losses and our customers' credit-worthiness. Amounts later determined and specifically identified to be uncollectible are charged or written off against this reserve.

We also reserve for potential disputed amounts or chargebacks with our customers. Our chargeback reserve is based on a collectibility percentage based on factors such as historical trends, current economic conditions, and nature of the chargeback receivables. We also reserve for potential sales returns and allowances based on historical trends.

The likelihood of a material loss on an uncollectible account would be mainly dependent on deterioration in the overall economic conditions in a particular country or environment. Reserves are fully provided for all probable losses of this nature. For receivables that are not specifically identified as high risk, we provide a reserve based upon a percent of sales for the preceding two months. This percentage is based on our historical loss rate. Gross trade accounts receivable balance was \$177.7 million and the allowance for bad debts, returns, sales allowances and customer chargebacks was \$10.3 million at December 31, 2007.

***Inventory write-downs.*** Inventories are stated at the lower of cost or market. We review our inventory on a regular basis for excess and slow moving inventory. Our review is based on inventory on hand, prior sales and our expected net realizable value. Our analysis includes a review of inventory quantities on hand at period end in relation to year-to-date sales and projections for sales in the near future. The net realizable value, or market value, is determined based on our estimate of sales prices of such inventory through off-price or discount store channels. A write-down of inventory is considered permanent and creates a new cost basis for those units. The likelihood of any material inventory write-down is dependent primarily on our expectation of future consumer demand for our

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product. A misinterpretation or misunderstanding of future consumer demand for our product or of the economy, or other failure to estimate correctly, could result in inventory valuation changes, either favorably or unfavorably, compared to the requirement determined to be appropriate as of the balance sheet date. At December 31, 2007, our gross inventory value was \$206.1 million and our inventory reserve was \$1.9 million.

**Valuation of long-lived assets.** When circumstances warrant, we assess the impairment of long-lived assets that require us to make assumptions and judgments regarding the carrying value of these assets. The assets are considered to be impaired if we determine that the carrying value may not be recoverable based upon our assessment of the following events or changes in circumstances:

the asset's ability to continue to generate income;

any loss of legal ownership or title to the asset(s);

any significant changes in our strategic business objectives and utilization of the asset(s); or

the impact of significant negative industry or economic trends.

If the assets are considered to be impaired, the impairment we recognize is the amount by which the carrying value of the assets exceeds the fair value of the assets. In addition, we base the useful lives and related amortization or depreciation expense on our estimate of the period that the assets will generate revenues or otherwise be used by us. If a change were to occur in any of the above-mentioned factors or estimates, the likelihood of a material change in our reported results would increase. In addition, we prepare a summary of store contribution from our domestic retail stores to assess potential impairment of the fixed assets and leasehold improvements. Stores with negative contribution opened in excess of twenty-four months are then reviewed in detail to determine if impairment exists. For the year ended December 31, 2007, we did not record an impairment charge.

**Litigation reserves.** Estimated amounts for claims that are probable and can be reasonably estimated are recorded as liabilities in our consolidated balance sheets. The likelihood of a material change in these estimated reserves would depend on new claims as they may arise and the favorable or unfavorable outcome of the particular litigation. Both the amount and range of loss on a large portion of the remaining pending litigation is uncertain. As such, we are unable to make a reasonable estimate of the liability that could result from unfavorable outcomes in litigation. As additional information becomes available, we will assess the potential liability related to our pending litigation and revise our estimates. Such revisions in our estimates of the potential liability could materially impact our results of operations and financial position.

**Valuation of deferred income taxes.** We record a valuation allowance when necessary to reduce our deferred tax assets to the amount that is more likely than not to be realized. The likelihood of a material change in our expected realization of our deferred tax assets depends on future taxable income and the effectiveness of our tax planning strategies amongst the various domestic and international tax jurisdictions in which we operate. We evaluate our projections of taxable income to determine the recoverability of our deferred tax assets and the need for a valuation allowance. As of December 31, 2007, we had net deferred tax assets of \$23.3 million reduced by a valuation allowance of \$0.7 million against loss carry-forwards not expected to be utilized by certain foreign subsidiaries.

**Uncertain tax positions.** Effective January 1, 2007, we adopted the provisions of Financial Accounting Standards Board Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (SFAS 109), which contains a two-step process for recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to determine whether or not a tax benefit should be recognized. A tax benefit will be recognized if the weight of available evidence indicates that the tax position is more likely than not to be sustained upon examination by the relevant tax authorities, assuming the tax authorities have full knowledge of all the relevant information. The second step is to measure the tax benefit of those tax positions meeting the more-likely-than-not recognition threshold. The tax benefit is measured at the largest amount of benefit that is more than 50% likely of being realized upon ultimate settlement with the tax authorities. The recognition and measurement of benefits related to our tax positions requires significant judgment as uncertainties often exist with respect to new laws, new interpretations of existing laws, and rulings by taxing

authorities. We recognized approximately a \$3.4 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings.



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**Foreign currency translation.** Our international operations generally use their respective local currencies as their functional currency. In accordance with Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation* ( SFAS 52 ), revenues and expenses from our international subsidiaries are translated using the monthly average exchange rates in effect for the period in which such revenues and expenses occur. International subsidiaries that use their local currency as their functional currency translate their assets and liabilities using current rates of exchange at the balance sheet date. The resulting translation gains and losses for such subsidiaries are included within accumulated other comprehensive income as a separate component of stockholders' equity. One international subsidiary has a functional currency of the U.S. dollar. Resulting remeasurement gains and losses from this subsidiary are included in the determination of net earnings. A substantial portion of our intercompany loans are considered long-term investments and the gains or losses from currency fluctuations are included as a component of translation adjustment in other comprehensive income.

**Stock-based compensation.** Beginning on January 1, 2006, we implemented and adopted a new critical accounting policy, Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123(R) ), which requires us to recognize compensation for stock options, nonvested shares and employee stock purchase plan ( ESPP ) shares at fair value. Under the fair value recognition provisions for SFAS 123(R), stock-based compensation cost is estimated at the grant date based on the fair value of the awards expected to vest and recognized as expense ratably over the requisite service period of the award. We have used the Black-Scholes valuation model to estimate the fair value of our stock option awards, which requires various judgmental assumptions including estimating stock price volatility, forfeiture rates, and expected life. Our computation of expected volatility is based on historical volatility. In addition, we consider many factors when estimating expected forfeitures and expected life, including types of awards, employee class, and historical experience. If any of the assumptions used in the Black-Scholes model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period. We adopted SFAS 123(R) using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. Stock compensation expense as a result of SFAS 123(R) was recorded to general and administrative expenses and was \$1.1 million and \$2.0 million for the year ended December 31, 2007 and 2006, respectively. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). The impact of the adoption is discussed in note 7 to the Consolidated Financial Statements.

**INFLATION**

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

**EXCHANGE RATES**

We receive U.S. dollars for substantially all of our product sales and our royalty income. Inventory purchases from offshore contract manufacturers are primarily denominated in U.S. dollars; however, purchase prices for our products may be impacted by fluctuations in the exchange rate between the U.S. dollar and the local currencies of the contract manufacturers, which may have the effect of increasing our cost of goods in the future. During 2007 and 2006, exchange rate fluctuations did not have a material impact on our inventory costs. We do not engage in hedging activities with respect to such exchange rate risk.

**FUTURE ACCOUNTING CHANGES**

In December 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards Statement No. 160 *Accounting for Noncontrolling Interests* ( SFAS 160 ), which clarifies the classification of noncontrolling interests in consolidated statements of financial position and the accounting for and reporting of transactions between the reporting entity and holders of such noncontrolling interests. SFAS 160 will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of this standard on our

Consolidated Financial Statements; however, we do not expect that the adoption of SFAS 160 will have a material impact on our financial condition or results of operations.

In December 2007, the FASB issued Statement of Financial Accounting Standards Statement No. 141(R) *Applying the Acquisition Method* ( SFAS 141(R) ), which clarifies the accounting for a business combination and requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their

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fair values as of that date. SFAS 141(R) will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of this standard on our Consolidated Financial Statements; however, we do not expect that the adoption of SFAS 141(R) will have a material impact on our financial condition or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards Statement No. 159 *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115* ( SFAS 159 ), which provides companies with an option to report selected financial assets and liabilities at fair value. Furthermore, SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 will be effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of this standard on our Consolidated Financial Statements; however, we do not expect that the adoption of SFAS 159 will have a material impact on our financial condition or results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards Statement No. 157 *Fair Value Measurements* , ( SFAS 157 ). The standard provides guidance for using fair value to measure assets and liabilities. The standard also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. Statement 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of this standard on our Consolidated Financial Statements; however, we do not expect that the adoption of SFAS 157 will have a material impact on our financial condition or results of operations.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### **MARKET RISK**

Market risk is the potential loss arising from the adverse changes in market rates and prices, such as interest rates, marketable debt security prices and foreign currency exchange rates. Changes in interest rates, marketable debt security prices and changes in foreign currency exchange rates have and will have an impact on our results of operations. We do not hold any derivative securities that require fair value presentation under FASB Statement No. 133.

**Market risk and interest rate fluctuations.** Our short-term investments consist of corporate and municipal debt and preferred stock auction rate securities. Recently, several auctions have failed as a result of illiquidity and imbalance in order flow for auction rate securities. A failed auction is not an indication of an increased credit risk or a reduction in the underlying collateral, however, parties wishing to sell securities could not do so. Based on current market conditions, it is not known when or if the capital markets will come back into balance to achieve successful auctions for these securities. If these auctions continue to fail, it could result in our holding securities beyond their next scheduled auction reset dates and will limit the short-term liquidity of these investments. We currently believe these securities are not significantly impaired, primarily due to the collateral underlying these securities and/or the creditworthiness of the issuer. Based on our expected operating cash flows, and our other sources and uses of cash, we do not anticipate that the potential lack of liquidity on these investments will affect our ability to execute our current business plan.

The interest rate charged on our line of credit facility is based on either the prime rate of interest or the LIBOR, and changes in either of these rates of interest could have an effect on the interest charged on our outstanding balances. At December 31, 2007, no amounts were outstanding that were subject to changes in interest rates.

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



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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULE**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Skechers U.S.A., Inc.:

We have audited the accompanying consolidated balance sheets of Skechers U.S.A., Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007. In connection with our audits of the consolidated financial statements, we also have audited the related financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Skechers U.S.A., Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in note 7 to the consolidated financial statements, effective January 1, 2006 the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*. As discussed in note 10 to the consolidated financial statements, effective January 1, 2007 the Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Skechers U.S.A. Inc.'s, internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 28, 2008 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Los Angeles, California

February 28, 2008

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders

Skechers U.S.A., Inc.:

We have audited Skechers U.S.A., Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Skechers U.S.A., Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Skechers U.S.A., Inc. maintained in all material respects effective internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Skechers U.S.A., Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2007, and the related financial statement schedule, and our report dated February 28, 2008 expressed an unqualified opinion on those consolidated financial statements and financial statement schedule.

/s/ KPMG LLP

Los Angeles, California

February 28, 2008

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**SKECHERS U.S.A., INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)

|                                                                                     | <b>December<br/>31,<br/>2007</b> | <b>December<br/>31,<br/>2006</b> |
|-------------------------------------------------------------------------------------|----------------------------------|----------------------------------|
| <b>ASSETS</b>                                                                       |                                  |                                  |
| Current Assets:                                                                     |                                  |                                  |
| Cash and cash equivalents                                                           | \$ 199,516                       | \$ 160,485                       |
| Short-term investments                                                              | 104,500                          | 60,000                           |
| Trade accounts receivable, less allowances of \$10,284 in 2007 and \$10,558 in 2006 | 167,406                          | 177,740                          |
| Other receivables                                                                   | 10,520                           | 8,035                            |
| Total receivables                                                                   | 177,926                          | 185,775                          |
| Inventories                                                                         | 204,211                          | 200,877                          |
| Prepaid expenses and other current assets                                           | 13,993                           | 15,321                           |
| Deferred tax assets                                                                 | 8,594                            | 9,490                            |
| Total current assets                                                                | 708,740                          | 631,948                          |
| Property and equipment, at cost, less accumulated depreciation and amortization     | 98,400                           | 87,645                           |
| Intangible assets, less accumulated amortization                                    | 78                               | 633                              |
| Deferred tax assets                                                                 | 13,983                           | 11,984                           |
| Other assets, at cost                                                               | 6,776                            | 4,843                            |
| <b>TOTAL ASSETS</b>                                                                 | <b>\$ 827,977</b>                | <b>\$ 737,053</b>                |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

|                                                      |         |         |
|------------------------------------------------------|---------|---------|
| Current Liabilities:                                 |         |         |
| Current installments of long-term borrowings         | 437     | 576     |
| Accounts payable                                     | 164,466 | 161,150 |
| Accrued expenses                                     | 19,949  | 19,435  |
| Total current liabilities                            | 184,852 | 181,161 |
| 4.50% convertible subordinated notes                 |         | 89,969  |
| Long-term borrowings, excluding current installments | 16,462  | 16,836  |
| Total liabilities                                    | 201,314 | 287,966 |
| Commitments and contingencies                        |         |         |
| Stockholders' equity:                                |         |         |



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|                                                                                                                                                                |            |            |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|
| Preferred Stock, \$.001 par value; 10,000 authorized; none issued and outstanding                                                                              |            |            |
| Class A Common Stock, \$.001 par value; 100,000 shares authorized; 32,992 and 28,103 shares issued and outstanding at December 31, 2007 and 2006, respectively | 33         | 28         |
| Class B Common Stock, \$.001 par value; 60,000 shares authorized; 12,852 and 13,768 shares issued and outstanding at December 31, 2007 and 2006, respectively  | 13         | 14         |
| Additional paid-in capital                                                                                                                                     | 258,084    | 156,374    |
| Accumulated other comprehensive income                                                                                                                         | 14,763     | 11,200     |
| Retained earnings                                                                                                                                              | 353,770    | 281,471    |
| Total stockholders' equity                                                                                                                                     | 626,663    | 449,087    |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY                                                                                                                     | \$ 827,977 | \$ 737,053 |

See accompanying notes to consolidated financial statements.

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**SKECHERS U.S.A., INC.**  
**CONSOLIDATED STATEMENTS OF EARNINGS**  
(In thousands, except per share data)

|                              | <b>Years ended December 31,</b> |              |              |
|------------------------------|---------------------------------|--------------|--------------|
|                              | <b>2007</b>                     | <b>2006</b>  | <b>2005</b>  |
| Net sales                    | \$ 1,394,181                    | \$ 1,205,368 | \$ 1,006,477 |
| Cost of sales                | 794,192                         | 682,022      | 585,995      |
| Gross profit                 | 599,989                         | 523,346      | 420,482      |
| Royalty income, net          | 4,179                           | 4,114        | 6,628        |
|                              | 604,168                         | 527,460      | 427,110      |
| Operating expenses:          |                                 |              |              |
| Selling                      | 126,527                         | 109,886      | 81,378       |
| General and administrative   | 364,711                         | 305,030      | 269,436      |
|                              | 491,238                         | 414,916      | 350,814      |
| Earnings from operations     | 112,930                         | 112,544      | 76,296       |
| Other income (expense):      |                                 |              |              |
| Interest income              | 10,040                          | 8,351        | 4,368        |
| Interest expense             | (4,763)                         | (9,227)      | (9,154)      |
| Other, net                   | 98                              | 980          | 1,287        |
|                              | 5,375                           | 104          | (3,499)      |
| Earnings before income taxes | 118,305                         | 112,648      | 72,797       |
| Income tax expense           | 42,619                          | 41,654       | 28,080       |
| Net earnings                 | \$ 75,686                       | \$ 70,994    | \$ 44,717    |
| Net earnings per share:      |                                 |              |              |
| Basic                        | \$ 1.67                         | \$ 1.73      | \$ 1.13      |
| Diluted                      | \$ 1.63                         | \$ 1.59      | \$ 1.06      |
| Weighted average shares:     |                                 |              |              |
| Basic                        | 45,262                          | 41,079       | 39,686       |
| Diluted                      | 46,741                          | 46,139       | 44,518       |

See accompanying notes to consolidated financial statements.



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**SKECHERS U.S.A., INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME**  
(In thousands)

|                                                                               | SHARES |        | AMOUNT |        | ACCUMULATED |               |            | TOTAL        |  |
|-------------------------------------------------------------------------------|--------|--------|--------|--------|-------------|---------------|------------|--------------|--|
|                                                                               | CLASS  | CLASS  | CLASS  | CLASS  | ADDITIONAL  | OTHER         | RETAINED   | STOCKHOLDERS |  |
|                                                                               | A      | B      | A      | B      | PAID-IN     | COMPREHENSIVE | EARNINGS   | EQUITY       |  |
|                                                                               | COMMON | COMMON | COMMON | COMMON | CAPITAL     | INCOME        |            |              |  |
|                                                                               | STOCK  | STOCK  | STOCK  | STOCK  |             |               |            |              |  |
| Balance at December 31, 2004                                                  | 22,234 | 17,011 | \$ 22  | \$ 17  | \$ 117,091  | \$ 12,005     | \$ 165,760 | \$ 294,895   |  |
| Comprehensive income:                                                         |        |        |        |        |             |               |            |              |  |
| Net earnings                                                                  |        |        |        |        |             |               | 44,717     | 44,717       |  |
| Foreign currency translation adjustment                                       |        |        |        |        |             | (4,966)       |            | (4,966)      |  |
| Total comprehensive income                                                    |        |        |        |        |             |               |            | 39,751       |  |
| Contribution of common stock to the 401(k) Plan                               | 59     |        |        |        | 767         |               |            | 767          |  |
| Proceeds from issuance of common stock under the employee stock purchase plan | 135    |        |        |        | 1,550       |               |            | 1,550        |  |
| Proceeds from issuance of common stock under the employee stock option plan   | 594    |        | 1      |        | 5,365       |               |            | 5,366        |  |
| Tax benefit of stock options exercised                                        |        |        |        |        | 1,501       |               |            | 1,501        |  |
| Conversion of Class B Common Stock into Class A Common Stock                  | 360    | (360)  |        |        |             |               |            |              |  |
| Balance at December 31,                                                       | 23,382 | 16,651 | \$ 23  | \$ 17  | \$ 126,274  | \$ 7,039      | \$ 210,477 | \$ 343,830   |  |

|                                                                               |        |         |       |       |            |           |            |            |        |         |  |
|-------------------------------------------------------------------------------|--------|---------|-------|-------|------------|-----------|------------|------------|--------|---------|--|
| 2005                                                                          |        |         |       |       |            |           |            |            |        |         |  |
| Comprehensive income:                                                         |        |         |       |       |            |           |            |            |        |         |  |
| Net earnings                                                                  |        |         |       |       |            |           |            | 70,994     |        | 70,994  |  |
| Foreign currency translation adjustment                                       |        |         |       |       |            |           |            |            | 4,161  | 4,161   |  |
| Total comprehensive income                                                    |        |         |       |       |            |           |            |            |        | 75,155  |  |
| Stock compensation expense                                                    |        |         |       |       |            |           |            |            | 2,029  | 2,029   |  |
| Proceeds from issuance of common stock under the employee stock purchase plan | 122    |         | 1     |       |            |           |            |            | 1,907  | 1,908   |  |
| Proceeds from issuance of common stock under the employee stock option plan   | 1,716  |         | 1     |       |            |           |            |            | 17,054 | 17,055  |  |
| Tax benefit of stock options exercised                                        |        |         |       |       |            |           |            |            | 9,110  | 9,110   |  |
| Conversion of Class B Common Stock into Class A Common Stock                  | 2,883  | (2,883) | 3     | (3)   |            |           |            |            |        |         |  |
| Balance at December 31, 2006                                                  | 28,103 | 13,768  | \$ 28 | \$ 14 | \$ 156,374 | \$ 11,200 | \$ 281,471 | \$ 449,087 |        |         |  |
| Comprehensive income:                                                         |        |         |       |       |            |           |            |            |        |         |  |
| Net earnings                                                                  |        |         |       |       |            |           |            | 75,686     |        | 75,686  |  |
| Foreign currency translation adjustment                                       |        |         |       |       |            |           |            |            | 3,563  | 3,563   |  |
| Total comprehensive income                                                    |        |         |       |       |            |           |            |            |        | 79,249  |  |
|                                                                               |        |         |       |       |            |           |            | (3,387)    |        | (3,387) |  |

|                                                                                                  |        |        |       |       |            |           |            |            |  |  |  |        |
|--------------------------------------------------------------------------------------------------|--------|--------|-------|-------|------------|-----------|------------|------------|--|--|--|--------|
| Cumulative effect of accounting change - adjustment to retained earnings upon adoption of FIN 48 |        |        |       |       |            |           |            |            |  |  |  |        |
| Redemption of convertible subordinated notes                                                     | 3,368  |        | 3     |       |            | 88,743    |            |            |  |  |  | 88,746 |
| Stock compensation expense                                                                       |        |        |       |       |            | 1,081     |            |            |  |  |  | 1,081  |
| Proceeds from issuance of common stock under the employee stock purchase plan                    | 99     |        |       |       |            | 2,066     |            |            |  |  |  | 2,066  |
| Proceeds from issuance of common stock under the employee stock option plan                      | 506    |        | 1     |       |            | 6,126     |            |            |  |  |  | 6,127  |
| Tax benefit of stock options exercised                                                           |        |        |       |       |            | 3,694     |            |            |  |  |  | 3,694  |
| Conversion of Class B Common Stock into Class A Common Stock                                     | 916    | (916)  | 1     | (1)   |            |           |            |            |  |  |  |        |
| Balance at December 31, 2007                                                                     | 32,992 | 12,852 | \$ 33 | \$ 13 | \$ 258,084 | \$ 14,763 | \$ 353,770 | \$ 626,663 |  |  |  |        |

See accompanying notes to consolidated financial statements

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**SKECHERS U.S.A., INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

|                                                                                                                 | <b>Years ended December 31,</b> |             |             |
|-----------------------------------------------------------------------------------------------------------------|---------------------------------|-------------|-------------|
|                                                                                                                 | <b>2007</b>                     | <b>2006</b> | <b>2005</b> |
| Cash flows from operating activities:                                                                           |                                 |             |             |
| Net earnings                                                                                                    | \$ 75,686                       | \$ 70,994   | \$ 44,717   |
| Adjustments to reconcile net earnings to net cash provided by operating activities:                             |                                 |             |             |
| Depreciation and amortization of property and equipment                                                         | 17,220                          | 16,203      | 22,070      |
| Amortization of deferred financing costs                                                                        | 95                              | 765         | 765         |
| Amortization of intangible assets                                                                               | 437                             | 502         | 523         |
| Provision for bad debts and returns                                                                             | 1,610                           | 4,591       | 2,882       |
| Tax benefits from stock-based compensation                                                                      | 1,456                           | 4,144       | 1,501       |
| Non cash stock compensation                                                                                     | 1,081                           | 2,030       |             |
| Provision for deferred taxes                                                                                    | (1,102)                         | (6,382)     | (6,322)     |
| Loss on disposal of equipment                                                                                   | 272                             | 299         | 170         |
| (Increase) decrease in assets:                                                                                  |                                 |             |             |
| Receivables                                                                                                     | 7,948                           | (47,994)    | (22,106)    |
| Inventories                                                                                                     | (3,045)                         | (64,364)    | 13,202      |
| Prepaid expenses and other current assets                                                                       | 1,417                           | (3,530)     | (871)       |
| Other assets                                                                                                    | (1,671)                         | 1,340       | (2,476)     |
| Increase (decrease) in liabilities:                                                                             |                                 |             |             |
| Accounts payable                                                                                                | 2,956                           | 49,563      | 13,777      |
| Accrued expenses                                                                                                | (3,005)                         | (2,122)     | 7,664       |
| Net cash provided by operating activities                                                                       | 101,355                         | 26,039      | 75,496      |
| Cash flows used in investing activities:                                                                        |                                 |             |             |
| Capital expenditures                                                                                            | (31,175)                        | (27,560)    | (13,627)    |
| Purchases of short-term investments                                                                             | (249,450)                       | (113,100)   |             |
| Maturities of short-term investments                                                                            | 204,950                         | 53,100      |             |
| Net cash used in investing activities                                                                           | (75,675)                        | (87,560)    | (13,627)    |
| Cash flows from financing activities:                                                                           |                                 |             |             |
| Net proceeds from the issuances of stock through employee stock purchase plan and the exercise of stock options | 8,193                           | 18,963      | 6,916       |
| Excess tax benefits from stock-based compensation                                                               | 2,238                           | 4,966       |             |
| Payments on long-term debt                                                                                      | (520)                           | (1,008)     | (7,660)     |
| Net cash provided by (used in) financing activities                                                             | 9,911                           | 22,921      | (744)       |
| Net increase (decrease) in cash and cash equivalents                                                            | 35,591                          | (38,600)    | 61,125      |
| Effect of exchange rates on cash and cash equivalents                                                           | 3,440                           | 2,078       | (1,771)     |
| Cash and cash equivalents at beginning of year                                                                  | 160,485                         | 197,007     | 137,653     |

|                                          |            |            |            |
|------------------------------------------|------------|------------|------------|
| Cash and cash equivalents at end of year | \$ 199,516 | \$ 160,485 | \$ 197,007 |
|------------------------------------------|------------|------------|------------|

Supplemental disclosures of cash flow information:

Cash paid during the year for:

|              |          |          |          |
|--------------|----------|----------|----------|
| Interest     | \$ 4,714 | \$ 8,560 | \$ 8,374 |
| Income taxes | 41,481   | 47,064   | 27,914   |

**SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:**

The Company issued 59,203 shares of Class A Common Stock to the Company's 401(k) plan, with a value of \$767,000 for the year ended December 31, 2005. No shares of Class A Common Stock were issued to the Company's 401(k) plan in 2006 or 2007. The Company issued approximately 3.5 million shares of Class A common stock to note holders upon conversion of our 4.50% convertible subordinated debt with a carrying value of \$89,969 for the year ended December 31, 2007.

See accompanying notes to consolidated financial statements.



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**SKECHERS U.S.A., INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2007, 2006 and 2005**

**(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**(a) The Company**

Skechers U.S.A., Inc. (the Company) designs, develops, markets and distributes footwear. The Company also operates retail stores and an e-commerce business.

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

**(b) Use of Estimates**

Management has made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with accounting principles generally accepted in the United States. Significant areas requiring the use of management estimates relate primarily to the revenue recognition, allowance for bad debts, returns, sales allowances and customer chargebacks, inventory write-downs, valuation of long-lived assets, litigation reserves, valuation of deferred income taxes, uncertain tax positions, foreign currency translation and stock-based compensation. Actual results could differ from those estimates.

**(c) Business Segment Information**

Skechers operations and segments are organized along its distribution channels and consists of the following: domestic wholesale, international wholesale, retail and e-commerce sales. Information regarding these segments is summarized in Note 14 to the Consolidated Financial Statements.

**(d) Revenue Recognition**

The Company recognizes revenue on wholesale sales when products are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. This generally occurs at the time of shipment. Allowances for estimated returns, sales allowances, discounts, doubtful accounts and chargebacks are provided for when related revenue is recorded. Related costs paid to third-party shipping companies are recorded as a cost of sales. The Company recognizes revenue from retail sales at the point of sale.

Net royalty income is earned from our licensing arrangements. Upon signing a new licensing agreement, we receive up-front fees, which are generally characterized as prepaid royalties. These fees are initially deferred and recognized as revenue as earned based on the terms of the contract (i.e., as licensed sales are reported to the company or on a straight line basis over the term of the agreement). The first calculated royalty payment is based on actual sales of the licensed product. Typically, at each quarter end we receive correspondence from our licensees indicating what the actual sales for the period were. This information is used to calculate and accrue the related royalties based on the terms of the agreement.

**(e) Cash and Cash Equivalents**

Cash and cash equivalents consist primarily of certificates of deposit with an initial term of less than three months. For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

**(f) Short Term Investments**

In general, investments with original maturities of greater than three months and remaining maturities of less than one year are classified as short-term investments. Highly liquid investments with maturities beyond one year may also be classified as short-term based on their liquidity, management's intentions and because such marketable securities represent the investment of cash that is available for current operations. Short-term investments consist of auction rate securities, which are corporate and municipal debt securities and preferred stocks which have underlying long-term maturities or preferred equity; however, they are traded and interest rates reset through a modified Dutch auction at predetermined short-term intervals of between 7 and 90 days.



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Recently, several auctions have failed as a result of illiquidity and the imbalance in order flow for auction rate securities. An auction failure means that the parties wishing to sell securities could not do so. Accordingly, there is no assurance that future auctions will continue to succeed, and as a result, our ability to liquidate our investments in the near term may be limited or may not exist. A failed auction is not an indication of an increased credit risk or a reduction in the underlying collateral. These securities are considered available-for-sale and recorded on the Company's consolidated financial statements at fair market value, with the unrealized gains and losses, net of tax, included in stockholders' equity.

**(g) Foreign Currency Translation**

In accordance with SFAS 52, certain international operations use the respective local currencies as their functional currency, while other international operations use the U.S. Dollar as their functional currency. The Company considers the U.S. dollar as its functional currency. The Company operates internationally through several foreign subsidiaries. Translation adjustments for these subsidiaries are included in other comprehensive income. Additionally, one international subsidiary, Skechers S.a.r.l. located in Switzerland, operates with a functional currency of the U.S. dollar. Resulting remeasurement gains and losses from this subsidiary are included in the determination of net earnings (loss). Assets and liabilities of the foreign operations denominated in local currencies are translated at the rate of exchange at the balance sheet date. Revenues and expenses are translated at the weighted average rate of exchange during the period. Translation of intercompany loans of a long-term investment nature are included as a component of translation adjustment in other comprehensive income.

**(h) Inventories**

Inventories, principally finished goods, are stated at the lower of cost (based on the first-in, first-out method) or market. The Company provides for estimated losses from obsolete or slow-moving inventories and writes down the cost of inventory at the time such determinations are made. Reserves are estimated based upon inventory on hand, historical sales activity, and the expected net realizable value. The net realizable value is determined based upon estimated sales prices of such inventory through off-price or discount store channels.

**(i) Income Taxes**

The Company accounts for income taxes in accordance with SFAS 109, which requires that the Company recognize deferred tax liabilities for taxable temporary differences and deferred assets for deductible temporary differences and operating loss carry-forwards using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit or expense is recognized as a result of changes in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all of any deferred tax assets will not be realized.

Effective January 1, 2007, we adopted the provisions of FIN 48, which contains a two-step process for recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to determine whether or not a tax benefit should be recognized. A tax benefit will be recognized if the weight of available evidence indicates that the tax position is more likely than not to be sustained upon examination by the relevant tax authorities. The recognition and measurement of benefits related to our tax positions requires significant judgment as uncertainties often exist with respect to new laws, new interpretations of existing laws, and rulings by taxing authorities. Differences between actual results and our assumptions, or changes in our assumptions in future periods, are recorded in the period they become known.

**(j) Depreciation and Amortization**

Depreciation and amortization of property and equipment is computed using the straight-line method based on the following estimated useful lives:

|                                   |                                                            |
|-----------------------------------|------------------------------------------------------------|
| Buildings                         | 20 years                                                   |
| Building improvements             | 10 years                                                   |
| Furniture, fixtures and equipment | 5 years                                                    |
| Leasehold improvements            | Useful life or remaining lease term, which ever is shorter |



**Table of Contents****(k) Intangible Assets**

Goodwill and indefinite-lived intangible assets are measured for impairment at least annually, and more often when events indicate that impairment exists. Intangible assets with finite lives continue to be amortized over their useful lives ranging from 5 to 10 years, generally on a straight-line basis. Intangible assets, all subject to amortization, as of December 31, 2007 and 2006 are as follows (in thousands):

|                                | <b>2007</b>  | <b>2006</b>   |
|--------------------------------|--------------|---------------|
| Intellectual property          | \$ 1,250     | \$ 1,250      |
| Other intangibles              | 1,000        | 1,000         |
| Trademarks                     | 1,050        | 1,050         |
| Less accumulated amortization  | (3,222)      | (2,667)       |
| <b>Total Intangible Assets</b> | <b>\$ 78</b> | <b>\$ 633</b> |

**(l) Long-Lived Assets**

Long-lived assets such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. The Company recognized impairment charges of approximately \$0.9 million 2005. The Company did not record an impairment charge in 2006 or 2007. The impairment charges in 2005 related to the write down of leasehold improvements of under-performing company owned retail stores. Fair value was based on estimated future cash flows.

**(m) Advertising Costs**

Advertising costs are expensed in the period in which the advertisements are first run or over the life of the endorsement contract. Advertising expense for the years ended December 31, 2007, 2006 and 2005 was approximately \$99.2 million, \$83.0 million, and \$58.2 million, respectively. Prepaid advertising costs at December 31, 2007 and 2006 were \$0.8 million and \$3.0 million, respectively. Prepaid amounts outstanding at December 31, 2007 and 2006 represent the unamortized portion of endorsement contracts and advertising in trade publications which had not run as of December 31, 2007 and 2006, respectively.

**(n) Earnings Per Share**

Basic earnings per share represents net earnings divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share, in addition to the weighted average determined for basic earnings per share, includes potential common shares which would arise from the exercise of stock options using the treasury stock method, and the conversion of the Company's 4.50% convertible subordinated notes for the period outstanding since their issuance in April 2002 until their conversion in February 2007, if their effects are dilutive.

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

|                                            | <b>Years Ended December 31,</b> |             |             |
|--------------------------------------------|---------------------------------|-------------|-------------|
| <b>Basic earnings per share</b>            | <b>2007</b>                     | <b>2006</b> | <b>2005</b> |
| Net earnings                               | \$75,686                        | \$70,994    | \$44,717    |
| Weighted average common shares outstanding | 45,262                          | 41,079      | 39,686      |
| Basic earnings per share                   | \$ 1.67                         | \$ 1.73     | \$ 1.13     |

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| <b>Diluted earnings per share</b>                                            | <b>Years Ended December 31,</b> |             |             |
|------------------------------------------------------------------------------|---------------------------------|-------------|-------------|
|                                                                              | <b>2007</b>                     | <b>2006</b> | <b>2005</b> |
| Net earnings                                                                 | \$ 75,686                       | \$ 70,994   | \$ 44,717   |
| After tax effect of interest expense on 4.50% convertible subordinated notes | 361                             | 2,553       | 2,487       |
| Earnings for purposes of computing diluted earnings per share                | \$ 76,047                       | \$ 73,547   | \$ 47,204   |
| Weighted average common shares outstanding                                   | 45,262                          | 41,079      | 39,686      |
| Dilutive stock options                                                       | 1,121                           | 1,594       | 1,366       |
| Weighted average assumed conversion of 4.50% convertible subordinated notes  | 358                             | 3,466       | 3,466       |
| Weighted average common shares outstanding                                   | 46,741                          | 46,139      | 44,518      |
| Diluted earnings per share                                                   | \$ 1.63                         | \$ 1.59     | \$ 1.06     |

Options to purchase 764,500 shares of Class A common stock at prices ranging from \$2.78 to \$24.00 that were outstanding at December 31, 2005 were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares and therefore their inclusion would have been anti-dilutive. There were no options excluded from the calculation at December 31, 2006 or 2007.

(o) Product Design and Development Costs

The Company charges all product design and development costs to expense when incurred. Product design and development costs aggregated approximately \$9.2 million, \$8.3 million, and \$6.0 million during the years ended December 31, 2007, 2006 and 2005, respectively.

(p) Fair Value of Financial Instruments

The carrying amount of the Company's financial instruments, which principally include cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses, approximates fair value due to the relatively short maturity of such instruments.

The carrying amount of the Company's long-term borrowings approximates the fair value based upon current rates and terms available to the Company for similar debt.

(q) New Accounting Standards

In December 2007, the FASB issued SFAS 160 *Accounting for Noncontrolling Interests*, which clarifies the classification of noncontrolling interests in consolidated statements of financial position and the accounting for and reporting of transactions between the reporting entity and holders of such noncontrolling interests. SFAS 160 will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of this standard on our Consolidated Financial Statements; however, we do not expect that the adoption of SFAS 160 will have a material impact on our financial condition or results of operations.

In December 2007, the FASB issued SFAS 141(R) *Applying the Acquisition Method*, which clarifies the accounting for a business combination and requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. SFAS 141(R) will be effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of this standard on our Consolidated Financial Statements; however, we do not expect that the adoption of SFAS 141(R) will have a material impact on our financial condition or results of operations.

In February 2007, the FASB issued SFAS 159 *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115*, which provides companies with an option to report selected financial assets and liabilities at fair value. Furthermore, SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for

similar types of assets and liabilities. SFAS 159 will be effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of this standard on our Consolidated Financial

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Statements; however, we do not expect that the adoption of SFAS 159 will have a material impact on our financial condition or results of operations.

In September 2006, the FASB issued SFAS 157 *Fair Value Measurements*, which provides guidance for using fair value to measure assets and liabilities. The standard also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. Statement 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of this standard on our Consolidated Financial Statements; however, we do not expect that the adoption of SFAS 157 will have a material impact on our financial condition or results of operations.

**(2) SHORT TERM INVESTMENTS**

Short-term investments consist of certain marketable equity securities and other investments aggregating \$104.5 million and \$60.0 million at December 31, 2007 and 2006, respectively, and are included in current assets in the accompanying consolidated balance sheets. Investments in highly liquid debt securities, municipal bonds and preferred stock are stated at fair value, which approximates cost. Unrealized gains and losses related to marketable equity securities at December 31, 2007 and 2006 were negligible.

Our available-for-sale securities at December 31, 2007 consisted of \$78.8 million of auction rate preferred stocks and \$25.7 million of auction rate municipal and corporate bonds whereby interest rates are reset on a recurring basis of between 7 and 90 days. The auction rate preferred stocks are collateralized by portfolios of municipal bonds issued by various state and local governments, and the fair value of the underlying collateral is required to be maintained at 200% of the amount of preferred stock. While all of the auctions involving all of the securities were successful during January 2008, the auctions failed in February 2008, resulting in our continuing to hold such securities. These failed auction are not an indication of an increased credit risk or a reduction in the underlying collateral, however it means that parties wishing to sell these securities could not do so. Based on current market conditions, it is not known when or if the capital markets will come back into balance to achieve successful auctions related for these securities. As of February 22, 2008, including the securities involved in failed auctions, we held \$110.7 million of these auction rate securities.

**(3) PROPERTY AND EQUIPMENT**

Property and equipment at December 31, 2007 and 2006 is summarized as follows (in thousands):

|                                                | <b>2007</b> | <b>2006</b> |
|------------------------------------------------|-------------|-------------|
| Land                                           | \$ 14,358   | \$ 14,358   |
| Buildings and improvements                     | 56,012      | 49,454      |
| Furniture, fixtures and equipment              | 85,354      | 81,164      |
| Leasehold improvements                         | 79,377      | 66,708      |
| Total property and equipment                   | 235,101     | 211,684     |
| Less accumulated depreciation and amortization | 136,701     | 124,039     |
| Property and equipment, net                    | \$ 98,400   | \$ 87,645   |

The Company capitalized \$0.9 million and \$0.3 million of interest expense during 2007 and 2006, respectively relating to the construction of our corporate headquarters.



**Table of Contents****(4) ACCRUED EXPENSES**

Accrued expenses at December 31, 2007 and 2006 are summarized as follows (in thousands):

|                                   | <b>2007</b> | <b>2006</b> |
|-----------------------------------|-------------|-------------|
| Accrued inventory purchases       | \$ 3,937    | \$ 4,678    |
| Accrued payroll and related taxes | 14,919      | 13,914      |
| Income taxes payable              | 1,058       |             |
| Accrued interest                  | 35          | 843         |
| Accrued expenses                  | \$ 19,949   | \$ 19,435   |

**(5) SHORT-TERM BORROWINGS**

On May 31, 2006, the Company amended its secured line of credit, which permits the Company and certain of its subsidiaries to borrow up to \$150.0 million based upon eligible accounts receivable and inventory, which line can be increased to \$250.0 million at our request. Borrowings bear interest at the borrowers' election based on either the prime rate or LIBOR. Prime rate loans will bear interest at a rate equal to JPMorgan Chase Bank's publicly announced prime rate less up to 0.50%. LIBOR loans will bear interest at a rate equal to the applicable LIBOR plus up to an additional 1.75%. The Company pays a monthly unused line of credit fee of 0.25% per annum. The loan agreement, which expires on May 31, 2011, provides for the issuance of letters of credit up to a maximum of \$30.0 million. The loan agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including a financial covenant requiring a fixed charge coverage ratio of not less than 1.1 at the end of each quarter if excess availability of eligible account receivable and inventory is less than \$50.0 million at any time during such quarter. Excess availability was not less than \$50.0 million during the three months ended December 31, 2007; hence, the fixed charge ratio requirement was not applicable at such date. No amounts were outstanding and the Company was in compliance with all other covenants of the loan agreement at December 31, 2007. The Company had \$9.6 million and \$10.0 million of outstanding letters of credit as of December 31, 2007 and 2006, respectively.

**(6) LONG-TERM BORROWINGS**

Long-term debt at December 31, 2007 and 2006 is as follows (in thousands):

|                                                                                                                                                                                                | <b>2007</b> | <b>2006</b> |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|
| 4.50% convertible subordinated notes due April 15, 2007 (see below)                                                                                                                            |             | \$ 90,000   |
| Note payable to bank, due in monthly installments of \$82.2 (includes principal and interest), fixed rate interest at 7.79%, secured by property, balloon payment of \$8,716 due January 2011  | \$ 9,557    | 9,790       |
| Note payable to bank, due in monthly installments of \$57.6 (includes principal and interest), fixed rate interest at 7.89%, secured by property, balloon payment of \$6,776 due February 2011 | 7,268       | 7,383       |
| Capital lease obligations                                                                                                                                                                      | 74          | 208         |
| Subtotal                                                                                                                                                                                       | 16,899      | 107,381     |
| Less current installments                                                                                                                                                                      | 437         | 576         |
| Total long-term debt                                                                                                                                                                           | \$ 16,462   | \$ 106,805  |

The aggregate maturities of long-term borrowings at December 31, 2007 are as follows:

|      |        |
|------|--------|
| 2008 | \$ 437 |
| 2009 | 395    |
| 2010 | 427    |

|      |           |
|------|-----------|
| 2011 | 15,640    |
|      | \$ 16,899 |

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On January 19, 2007, we called our 4.5% convertible subordinated notes for redemption. The redemption date was February 20, 2007. The aggregate principal amount of notes outstanding was \$90.0 million. Holders of \$89.969 million principal amount of the notes, which included \$2.5 million of principal amount of the notes held by us, converted their notes into shares of our Class A Common Stock prior to the redemption date. As a result of these conversions, 3,464,594 shares of Class A Common Stock were issued to holders of the notes, which included 96,272 shares issued to the Company that were immediately retired. In connection with these conversions, the Company paid approximately \$500 in cash to holders who elected to convert their notes, which represented cash paid in lieu of fractional shares. In addition, the Company paid approximately \$32,000 to holders who redeemed their notes, which represented the redemption price of 100.9% of \$31,000 principal amount of the notes plus accrued interest. As a result of the subsequent conversion of \$89.969 million of the notes into equity, the Company has classified such amount as a long-term liability at December 31, 2006, under Statement of Financial Accounting Standards No. 6, *Classification of Short-Term Obligations Expected to Be Refinanced* an amendment of ARB No. 43, Chapter 3.

The Company's long-term debt obligations contain both financial and non-financial covenants, including cross default provisions. The Company is in compliance with all its material non-financial covenants, including any cross default provisions, and financial covenants of our long-term debt as of December 31, 2007.

**(7) STOCK COMPENSATION**

(a) Impact of the adoption of SFAS No. 123 (revised 2004), *Share-Based Payment* ( SFAS 123(R) )

On January 1, 2006, the Company adopted SFAS 123(R) using the modified prospective transition method. Previously, the Company had followed Accounting Principles Board, Opinion No. 25, *Accounting for Stock Issued to Employees*, ( APB 25 ), and accounted for employee stock options at intrinsic value. Accordingly, during the year ended December 31, 2006, we recorded stock-based compensation expense for awards granted prior to, but not yet vested as of, January 1, 2006, as if the fair value method required for pro forma disclosure under SFAS 123 were in effect for expense recognition purposes, adjusted for estimated forfeitures. For stock-based awards granted after January 1, 2006, we have recognized compensation expense based on the grant date fair value using the Black-Scholes valuation model. For these awards, we have recognized compensation expense on a straight-line basis. As SFAS 123(R) requires that stock-based compensation expense be based on awards that are ultimately expected to vest, stock-based compensation for the year ended December 31, 2007 and 2006 has been reduced for estimated forfeitures. For the year ended December 31, 2007 and 2006, stock compensation expense as a result of SFAS 123(R) was \$1.1 million and \$2.0 million, respectively, and was recorded to general and administrative expenses which represented a reduction of earnings before income taxes in the same amount. The impact to 2007 and 2006 net income was a reduction of \$0.9 million and \$1.6 million, respectively. No stock compensation expense was recorded during 2005.

(b) Equity Incentive Plans

In January 1998, the Company's Board of Directors adopted the 1998 Stock Option, Deferred Stock and Restricted Stock Plan for the grant of qualified incentive stock options ( ISOs ), non qualified stock options and deferred and restricted stock (the Equity Incentive Plan ). The exercise price for any option granted may not be less than fair value (110% of fair value for ISOs granted to certain employees). In June 2001, the stockholders approved an amendment to the plan to increase the number of shares of Class A Common Stock authorized for issuance under the plan to 8,215,154. In May 2003, stockholders approved an amendment to the plan to increase the number of shares of Class A Common Stock authorized for issuance under the plan to 11,215,154. Option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant. Stock option awards generally become exercisable over a four-year graded vesting period and expire ten years from the date of grant.

On April 16, 2007, the Company's Board of Directors adopted the 2007 Incentive Award Plan (the 2007 Plan ), and the 2007 Plan became effective upon approval by the Company's stockholders on May 24, 2007. The Company's Board of Directors terminated the Equity Incentive Plan as of May 24, 2007, with no additional granting of awards being permitted thereafter, although any awards then outstanding under the Equity Incentive Plan remain in force according to the terms of the terminated plan and the applicable award agreements. A total of 7,500,000 shares of Class A Common Stock are reserved for issuance under the 2007 Plan, which provides for grants of stock options, restricted stock and various other types of awards as described in the plan to the employees, consultants and directors of the

Company and its subsidiaries. The 2007 Plan is administered by the Compensation Committee of the Company's Board of Directors.

Prior to adopting SFAS 123(R), we presented all tax benefits resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. SFAS 123(R) requires cash flows resulting from excess tax benefits to be classified as a part of cash

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flows from financing activities. Excess tax benefits are realized from tax deductions for exercised options and vesting of nonvested stock in excess of the deferred tax assets attributable to stock compensation costs for such options. As a result of adopting SFAS 123(R), \$2.2 million and \$5.0 million of excess tax benefits for the year-ended December 31, 2007 and 2006 have been classified as a financing cash inflow. Cash received from stock option exercises for the year-ended December 31, 2007, 2006 and 2005 was \$6.1 million, \$17.1 million and \$5.4 million, respectively. The actual tax benefit realized for the tax deductions from option exercise of stock options and vesting of nonvested shares totaled \$3.4 million, \$9.3 million and \$1.5 million for the year-ended December 31, 2007, 2006 and 2005, respectively. The total income tax benefit recognized for stock-based compensation costs was \$0.1 million and \$0.4 million for the year ended December 31, 2007 and 2006, respectively. No income tax benefit for stock-based compensation costs was recognized for the year ended December 31, 2005. The impact of SFAS 123(R) stock-based compensation expense was a reduction of \$0.02 earnings per basic and per diluted share for the year ended December 31, 2007. The impact of SFAS 123(R) stock-based compensation expense was a reduction of \$0.05 earnings per basic and \$0.04 per diluted share for the year ended December 31, 2006. The Company plans to issue new shares for stock options exercised and nonvested shares that vest.

**(c) Valuation Assumptions**

For pro forma net earnings purposes, the fair value of each option is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the following table. Expected volatility is based on historical share price data. The Company uses historical employee exercise and cancellation data to estimate expected term and forfeiture rates. The risk-free rate is based on U.S. Treasury yields in effect at the time of grant. Employees that have similar historical exercise behavior are considered separately for valuation purposes. Option valuation methods require the input of highly subjective assumptions including the expected stock price volatility, expected term and forfeiture rate. Because the Black-Scholes based option valuation models incorporate ranges of assumptions for inputs, those inputs are disclosed in the table as follows:

|                         | <b>2006</b> | <b>2005</b> |
|-------------------------|-------------|-------------|
| Dividend yield          |             |             |
| Expected volatility     | 62%         | 71%         |
| Risk-free interest rate | 4.52%       | 3.88%       |
| Expected life of option | 7           | 5           |

There were no ISO s granted during 2007. Using the Black-Scholes option valuation model the weighted-average fair value per share of options granted during 2006 and 2005 was \$12.70, and \$8.28, respectively. The total intrinsic value of options exercised during 2007, 2006 and 2005 was \$9.9 million, \$25.5 million, and \$4.0 million, respectively.

**(d) Stock-Based Payment Awards**

Shares subject to option under the Equity Incentive Plan were as follows:

|                                  | <b>SHARES</b> | <b>WEIGHTED<br/>OPTION EXERCISE<br/>PRICE</b> |
|----------------------------------|---------------|-----------------------------------------------|
| Outstanding at December 31, 2004 | 4,975,341     | \$ 10.90                                      |
| Granted                          | 35,000        | 13.52                                         |
| Exercised                        | (593,671)     | 9.04                                          |
| Canceled                         | (207,233)     | 14.89                                         |
| Outstanding at December 31, 2005 | 4,209,437     | 10.98                                         |
| Granted                          | 15,000        | 19.49                                         |
| Exercised                        | (1,711,945)   | 9.96                                          |
| Canceled                         | (26,910)      | 10.35                                         |

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|                                                  |           |    |       |
|--------------------------------------------------|-----------|----|-------|
| Outstanding at December 31, 2006                 | 2,485,582 |    | 11.74 |
| Granted                                          |           |    |       |
| Exercised                                        | (501,874) |    | 12.23 |
| Canceled                                         | (21,952)  |    | 16.86 |
| Outstanding at December 31, 2007                 | 1,961,756 | \$ | 11.56 |
| Options available for grant at December 31, 2007 | 3,258,209 |    |       |

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As of December 31, 2007, there was approximately \$0.3 million of total unrecognized compensation cost related to unvested stock options and restricted stock granted under our Equity Incentive Plan. That cost is expected to be recognized over a weighted average period of 1 year. The total fair value of shares vested during the period ended December 31, 2007 was \$1.1 million. The following table summarizes information about stock options outstanding and exercisable at December 31, 2007:

| RANGE OF<br>EXERCISE PRICE | OPTIONS OUTSTANDING                        |                                                         |                                          | OPTIONS EXERCISABLE                              |                                          |
|----------------------------|--------------------------------------------|---------------------------------------------------------|------------------------------------------|--------------------------------------------------|------------------------------------------|
|                            | NUMBER<br>OUTSTANDING<br>DECEMBER 31, 2007 | WEIGHTED<br>AVERAGE<br>REMAINING<br>CONTRACTUAL<br>LIFE | WEIGHTED<br>AVERAGE<br>EXERCISE<br>PRICE | NUMBER<br>EXERCISABLE<br>AT<br>DECEMBER 31, 2007 | WEIGHTED<br>AVERAGE<br>EXERCISE<br>PRICE |
| \$2.78 to \$3.94           | 29,812                                     | 2.1 years                                               | \$ 3.93                                  | 29,812                                           | \$ 3.93                                  |
| \$6.95 to \$9.28           | 717,873                                    | 5.4 years                                               | 7.46                                     | 717,873                                          | 7.46                                     |
| \$10.48 to \$15.50         | 1,047,355                                  | 3.0 years                                               | 12.65                                    | 1,033,355                                        | 12.64                                    |
| \$19.19 to \$24.00         | 166,716                                    | 3.1 years                                               | 23.71                                    | 166,716                                          | 23.71                                    |
|                            | 1,961,756                                  | 3.9 years                                               | \$ 11.56                                 | 1,947,756                                        | \$ 11.55                                 |

As of December 31, 2007, 2006 and 2005, the number of options exercisable for each year was 1,947,756, 2,261,707, and 3,718,812, respectively. The weighted-average exercise price of those options was \$11.55, \$11.97, and \$11.27, respectively. The total intrinsic value of options outstanding and exercisable at December 31, 2007 was \$16.3 million and \$16.2 million, respectively. The total intrinsic value of options outstanding and exercisable at December 31, 2006 was \$29.2 million and \$27.1 million, respectively. The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the 1.8 million options that were in-the-money at December 31, 2007.

A summary of the status and changes of our nonvested shares related to our Equity Incentive Plan as of and during the period ended December 31, 2007 is presented below:

|                                | SHARES  | WEIGHTED<br>AVERAGE<br>GRANT-DATE<br>FAIR<br>VALUE |
|--------------------------------|---------|----------------------------------------------------|
| Nonvested at December 31, 2006 | 17,333  | \$ 16.38                                           |
| Granted                        | 2,500   | 29.26                                              |
| Vested                         | (4,666) | 17.00                                              |
| Nonvested at December 31, 2007 | 15,167  | \$ 18.32                                           |

The nonvested shares generally vest over a four-year graded vesting period and expire ten years from the date of grant.

(e) Stock Purchase Plans

Effective July 1, 1998, the Company's Board of Directors adopted the 1998 Employee Stock Purchase Plan (the 1998 ESPP). The 1998 ESPP provides that a total of 2,781,415 shares of Class A Common Stock are reserved for issuance under the plan. The 1998 ESPP, which is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code of 1986, as amended, is implemented utilizing six-month offerings with

purchases occurring at six-month intervals. The 1998 ESPP administration is overseen by the Board of Directors. Employees are eligible to participate if they are employed by the Company for at least 20 hours per week and more than five months in any calendar year. The 1998 ESPP permits eligible employees to purchase Class A Common Stock through payroll deductions, which may not exceed 15% of an employee's compensation. The price of Class A Common Stock purchased under the 1998 ESPP is 85% of the lower of the fair market value of the Class A Common Stock at the beginning of each six-month offering period or on the applicable purchase date. Employees may end their participation in an offering at any time during the offering period. The Board may at any time amend or terminate the 1998 ESPP, except that no such amendment or termination may adversely affect shares previously granted under the 1998 ESPP. During 2007, 2006 and 2005, 98,349, 121,378, and 135,387 shares were issued, respectively, under the 1998 ESPP for which the Company received approximately \$2.1 million, \$1.9 million, and \$1.6 million, respectively.



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On April 16, 2007, the Company's Board of Directors adopted the 2008 Employee Stock Purchase Plan (the "2008 ESPP"), and the Company's stockholders approved the 2008 ESPP on May 24, 2007. The 2008 ESPP became effective on January 1, 2008, and the Company's Board of Directors terminated the 1998 ESPP as of such date, with no additional granting of rights being permitted under the 1998 ESPP. The 2008 ESPP provides that a total of 3,000,000 shares of Class A Common Stock are reserved for issuance under the plan. This number of shares that may be made available for sale is subject to automatic increases on the first day of each fiscal year during the term of the 2008 ESPP as provided in the plan. The 2008 ESPP is intended to qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code of 1986, as amended. The terms of the 2008 ESPP, which are substantially similar to those of the 1998 ESPP, permit eligible employees to purchase Class A Common Stock at six-month intervals through payroll deductions, which may not exceed 15% of an employee's compensation. The price of Class A Common Stock purchased under the 2008 ESPP is 85% of the lower of the fair market value of the Class A Common Stock at the beginning of each six-month offering period or on the applicable purchase date. The 2008 ESPP is administered by the Company's Board of Directors.

(f) Pro Forma Information for Periods Prior to the Adoption of SFAS 123(R)

The following table illustrates the effects on net earnings if compensation cost for the Company's stock option plans and its stock purchase plans had been determined based on the estimated fair value at the grant dates for awards under those plans consistent with the fair value method of SFAS 123 utilizing the Black-Scholes option-pricing model in each period (in thousands):

|                                                                                                                                 | <b>2005</b> |
|---------------------------------------------------------------------------------------------------------------------------------|-------------|
| Net earnings, as reported                                                                                                       | \$ 44,717   |
| Deduct total stock-based employee compensation expense under fair value-based method for all awards, net of related tax effects | (1,853)     |
| Pro forma net earnings for basic pro forma earnings per share                                                                   | 42,864      |
| Add back interest on 4.50% debentures, net of tax                                                                               | 2,487       |
| Pro forma net earnings for diluted pro forma earnings per share                                                                 | \$ 45,351   |
| Pro forma net earnings per share:                                                                                               |             |
| Basic                                                                                                                           | \$ 1.08     |
| Diluted                                                                                                                         | 1.02        |

Pro forma basic net earnings per share represents net pro forma earnings divided by the weighted average number of common shares outstanding for the period. Pro forma diluted earnings per share, in addition to the weighted average determined for pro forma basic earnings per share, includes the dilutive effect of potentially dilutive securities which would arise from the exercise of stock options using the treasury stock method, and assumes the conversion of the Company's 4.50% convertible subordinated notes if their effects are dilutive.

**(8) STOCKHOLDERS' EQUITY**

**Stock Issuances**

The authorized capital stock of the Company consists of 100,000,000 shares of Class A Common Stock, par value \$.001 per share, 60,000,000 shares of Class B Common Stock, par value \$.001 per share, and 10,000,000 shares of preferred stock, \$.001 par value per share.

The Class A Common Stock and Class B Common Stock have identical rights other than with respect to voting, conversion and transfer. The Class A Common Stock is entitled to one vote per share, while the Class B Common Stock is entitled to ten votes per share on all matters submitted to a vote of stockholders. The shares of Class B Common Stock are convertible at any time at the option of the holder into shares of Class A Common Stock on a share-for-share basis. In addition, shares of Class B Common Stock will be automatically converted into a like number of shares of Class A Common Stock upon any transfer to any person or entity which is not a permitted transferee.

During 2007, 2006 and 2005 certain Class B stockholders converted 916,400, 2,883,000, and 360,000 shares, respectively, of Class B Common Stock to Class A Common Stock.

**Table of Contents****(9) TOTAL OTHER INCOME (EXPENSE), NET**

Other income (expense), net at December 31, 2007, 2006 and 2005 is summarized as follows (in thousands):

|                                              | <b>2007</b> | <b>2006</b> | <b>2005</b> |
|----------------------------------------------|-------------|-------------|-------------|
| Gain (loss) on foreign currency transactions | \$ (295)    | \$ 116      | \$ (351)    |
| Legal settlements                            | 393         | 864         | 1,638       |
| Total other income, net                      | \$ 98       | \$ 980      | \$ 1,287    |

**(10) INCOME TAXES**

The provisions for income tax expense were as follows (in thousands):

|                    | <b>2007</b> | <b>2006</b> | <b>2005</b> |
|--------------------|-------------|-------------|-------------|
| Federal:           |             |             |             |
| Current            | \$ 33,354   | \$ 38,252   | \$ 27,562   |
| Deferred           | (301)       | (4,451)     | (4,157)     |
| Total federal      | 33,053      | 33,801      | 23,405      |
| State:             |             |             |             |
| Current            | 7,255       | 7,398       | 5,417       |
| Deferred           | (66)        | (586)       | (588)       |
| Total state        | 7,189       | 6,812       | 4,829       |
| Foreign :          |             |             |             |
| Current            | 2,686       | 2,192       | 1,423       |
| Deferred           | (309)       | (1,151)     | (1,577)     |
| Total foreign      | 2,377       | 1,041       | (154)       |
| Total income taxes | \$ 42,619   | \$ 41,654   | \$ 28,080   |

Income taxes differ from the statutory tax rates as applied to earnings before income taxes as follows (in thousands):

|                                          | <b>2007</b> | <b>2006</b> | <b>2005</b> |
|------------------------------------------|-------------|-------------|-------------|
| Expected income tax expense              | \$ 41,407   | \$ 39,427   | \$ 25,479   |
| State income tax, net of federal benefit | 4,444       | 4,611       | 3,585       |
| Rate differential on foreign income      | (3,119)     | (379)       | (720)       |
| Exempt income                            | (1,026)     | (260)       |             |
| Non-deductible expenses                  | 464         | 949         | 321         |
| Change in valuation allowance            | 194         | (967)       | (974)       |
| Other                                    | 255         | (1,727)     | 389         |
| Total provision for income taxes         | \$ 42,619   | \$ 41,654   | \$ 28,080   |

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The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities at December 31, 2007 and 2006 are presented below (in thousands):

|                                          | 2007      | 2006      |
|------------------------------------------|-----------|-----------|
| <b>DEFERRED TAX ASSETS:</b>              |           |           |
| Deferred tax assets    current:          |           |           |
| Inventory adjustments                    | \$ 2,555  | \$ 2,991  |
| Accrued expenses                         | 6,540     | 4,661     |
| Allowances for bad debts and chargebacks | 2,570     | 4,732     |
| Total current assets                     | 11,665    | 12,384    |
| Deferred tax assets    long term:        |           |           |
| Depreciation on property and equipment   | 11,441    | 9,633     |
| Loss carryforwards                       | 3,133     | 2,737     |
| Valuation allowance                      | (682)     | (488)     |
| Stock-based compensation                 | 91        | 102       |
| Total long term assets                   | 13,983    | 11,984    |
| Total deferred tax assets                | 25,648    | 24,368    |
| Deferred tax liabilities    current:     |           |           |
| Prepaid expenses                         | 3,071     | 2,710     |
| Other                                    |           | 184       |
| Total deferred tax liabilities           | 3,071     | 2,894     |
| Net deferred tax assets                  | \$ 22,577 | \$ 21,474 |

Management believes it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax assets.

Consolidated U.S. income before income taxes was \$101.4 million, \$104.8 million, and \$66.0 million for the years ended December 31, 2007, 2006 and 2005, respectively. The corresponding income before income taxes for non-U.S. based operations was \$16.9 million, \$7.8 million, and \$6.8 million for the years ended December 31, 2007, 2006 and 2005, respectively.

As of December 31, 2007 and 2006, Skechers had combined foreign operating loss carry-forwards available to reduce future taxable income of approximately \$8.7 million and \$7.4 million, respectively. Some of these net operating losses expire beginning in 2011, however others can be carried forward indefinitely. As of December 31, 2007 and 2006, a valuation allowance against deferred tax assets of \$0.7 million and \$0.5 million, respectively, had been set up for those loss carry-forwards not expected to be fully utilized in reducing future taxable income.

As of December 31, 2007, withholding and U.S. taxes have not been provided on approximately \$15.5 million of cumulative undistributed earnings of the Company's non-U.S. subsidiaries because the Company intends to indefinitely reinvest these earnings in its non-U.S. subsidiaries.

We adopted the provisions FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, we recognized approximately a \$3.4 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007 balance of retained earnings. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|                                                       |           |
|-------------------------------------------------------|-----------|
| Balance as of January 1, 2007                         | \$ 11,241 |
| Additions based on current year tax positions         | 6,836     |
| Additions for prior year tax positions                | 1,015     |
| Reductions for prior year tax positions               | (287)     |
| Settlement of uncertain tax positions                 | (504)     |
| Reductions related to lapse of statute of limitations | (36)      |
| Balance at December 31, 2007                          | \$ 18,265 |

If recognized, the entire amount of unrecognized tax benefits would be recorded as a reduction in income tax expense.

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Estimated interest and penalties related to the underpayment of income taxes are classified as a component of income tax expense and totaled \$0.5 million, \$0.1 million, and \$0.1 million for the years ended December 31, 2007, 2006 and 2005, respectively. Accrued interest and penalties were \$1.3 million and \$1.1 million as of December 31, 2007 and December 31, 2006, respectively.

The Company files income tax returns in the U.S. federal jurisdiction and various state, local and foreign jurisdictions. The Company has completed U.S. federal audits through 2003, and is not currently under examination by the United States Internal Revenue Service (the "IRS"); however the company is under examination by a number of states. It is reasonably possible that most or all of these examinations could be settled within the next twelve months which would reduce the balance of 2007 and prior year unrecognized tax benefits by \$1.2 million.

With few exceptions, the Company is no longer subject to state, local or non-U.S. income tax examinations by tax authorities for years before 2004. Tax years 2004 through 2006 remain open to examination by the U.S. federal, state, and foreign taxing jurisdictions under which we are subject. It is reasonably possible that the statute of limitations for the 2004 tax year will lapse for the U.S. federal and most state tax jurisdictions during 2008, which would reduce the balance of 2007 and prior year unrecognized tax benefits by \$2.5 million.

We have applied for advanced pricing agreements with various tax authorities related to the pricing of certain intercompany transactions. It is reasonably possible that we will receive final decisions on these applications within the next twelve months which would reduce the balance of 2007 and prior year unrecognized tax benefits by \$11.2 million, and, depending on how it is resolved, that reduction may or may not impact earnings. If the advanced pricing agreements are not resolved in 2008, we will continue to add to the unrecognized tax benefits, as we did in 2006 and 2007, and that increase could be approximately \$8.0 million to \$10.0 million.

### **(11) BUSINESS AND CREDIT CONCENTRATIONS**

The Company operates in the footwear industry and generates most of its sales in the United States, although its products are sold into various foreign countries. The footwear industry is impacted by the general economy. Changes in the marketplace may significantly affect management's estimates and the Company's performance. Management performs regular evaluations concerning the ability of its customers to satisfy their obligations and provides for estimated doubtful accounts. Domestic accounts receivable, which generally do not require collateral from customers, amounted to \$110.3 million and \$141.7 million before allowances for bad debts and sales returns, and chargebacks at December 31, 2007 and 2006, respectively. Foreign accounts receivable, which generally are collateralized by letters of credit, amounted to \$67.4 million and \$46.6 million before allowance for bad debts, sales returns, and chargebacks at December 31, 2007 and 2006, respectively. International net sales amounted to \$291.3 million, \$203.3 million, and \$179.6 million for the years ended December 31, 2007, 2006 and 2005, respectively. The Company's credit losses due to write-offs for the years ended December 31, 2007, 2006 and 2005 were \$1.6 million, \$4.6 million, and \$2.9 million respectively, and did not significantly differ from management's expectations.

Net sales to customers in North America exceeded 75% of total net sales for each of the years in the three-year period ended December 31, 2007. Assets located outside the United States consist primarily of cash, accounts receivable, inventory, property and equipment, and other assets. Net assets held outside the United States were \$126.1 million and \$119.1 million at December 31, 2007 and 2006, respectively.

During 2007, 2006, and 2005, no customer accounted for 10% or more of net sales. One customer accounted for 10.0%, 12.0% and 10.3% of net trade receivables at December 31, 2007, 2006 and 2005, respectively. During 2007, 2006 and 2005, our net sales to our five largest customers were approximately 25.3%, 24.9%, and 25.4%, respectively.

During 2007, the Company had four manufacturers which accounted for between 7.9% and 29.7% of total purchases. During 2006, the Company had four manufacturers which accounted for between 8.9% and 30.8% of total purchases. During 2005, the Company had four manufacturers which accounted for between 7.9% and 32.4% of total purchases.

Most of the Company's products are produced in China. The Company's operations are subject to the customary risks of doing business abroad, including, but not limited to, currency fluctuations, custom duties and related fees, various import controls and other monetary barriers, restrictions on the transfer of funds, labor unrest and strikes and, in certain parts of the world, political instability. The Company believes it has acted to reduce these risks by

diversifying manufacturing among various factories. To date, these risk factors have not had a material adverse impact on the Company's operations.

**Table of Contents****(12) BENEFIT PLAN**

The Company has adopted a profit sharing plan covering all employees who are 21 years of age and have completed six months of service. Employees may contribute up to 15.0% of annual compensation. Company contributions to the plan are discretionary and vest over a six year period.

The Company's contributions to the plan amounted to \$1.2 million, \$1.1 million, and \$0.8 million for the years ended December 31, 2007, 2006 and 2005, respectively. For 2006 and 2007, the Company made a cash contribution. For its contribution to the plan for 2005, the Company issued 59,203, shares of its Class A Common Stock. The shares contributed to the plan contain certain restrictions regarding the subsequent sales of those shares.

**(13) COMMITMENTS AND CONTINGENCIES****(a) Construction**

During 2005, we entered into a construction agreement with Morley Construction Company for the construction of our third corporate facility in Manhattan Beach, California. The agreement has a maximum payment clause in which Morley agrees that the construction cost of the facility will not exceed \$18.1 million plus change orders of \$1.7 million, of which \$19.2 million was incurred as of December 31, 2007. The exterior of the facility was completed in 2007, and while we are currently working on the interior improvements, we expect to move in during 2008.

**(b) Leases**

The Company leases facilities under operating lease agreements expiring through July 2027. The Company pays taxes, maintenance and insurance in addition to the lease obligation. The Company also leases certain equipment and automobiles under operating lease agreements expiring at various dates through April 2007. Rent expense for the years ended December 31, 2007, 2006 and 2005 approximated \$48.9 million, \$40.4 million, and \$37.2 million, respectively.

The Company also leases certain property and equipment under capital lease agreements requiring monthly installment payments through February 2010. The cost of this property and equipment was \$0.1 million with a net book value of \$0.1 million at December 31, 2007. The cost of this property and equipment was \$2.0 million with a net book value of \$0.5 million at December 31, 2006. Amortization of these assets is included in depreciation expense in the accompanying consolidated statements of cash flows.

Minimum lease payments, which takes into account escalation clauses, are recognized on a straight-line basis over the minimum lease term. Subsequent adjustments to our lease payments due to changes in an existing index, usually the consumer price index, are typically included in our calculation of the minimum lease payments when the adjustment is known. Reimbursements for leasehold improvements are recorded as liabilities and are amortized over the lease term. Lease concessions, in our case usually a free rent period, are considered in the calculation of our minimum lease payments for the minimum lease term.

Future minimum lease payments under noncancellable leases at December 31, 2007 are as follows (in thousands):

|                                             | <b>CAPITAL<br/>LEASES</b> | <b>OPERATING<br/>LEASES</b> |
|---------------------------------------------|---------------------------|-----------------------------|
| Year ending December 31:                    |                           |                             |
| 2008                                        | \$ 74                     | \$ 47,124                   |
| 2009                                        | 6                         | 55,068                      |
| 2010                                        |                           | 51,271                      |
| 2011                                        |                           | 44,559                      |
| 2012                                        |                           | 36,937                      |
| Thereafter                                  |                           | 176,617                     |
|                                             | 80                        | \$ 411,576                  |
| Less imputed interest                       | 6                         |                             |
| Present value of net minimum lease payments | \$ 74                     |                             |





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(c) Litigation

The Company recognizes legal expense in connection with loss contingencies as incurred.

On March 25, 2003, a shareholder securities class action complaint captioned HARVEY SOLOMON v. SKECHERS USA, INC. et al. was filed against the Company and certain of its officers and directors in the United States District Court for the Central District of California (Case No. 03-2094 DDP). On April 2, 2003, a shareholder securities class action complaint captioned CHARLES ZIMMER v. SKECHERS USA, INC. et al. was filed against the Company and certain of its officers and directors in the United States District Court for the Central District of California (Case No. 03-2296 PA). On April 15, 2003, a shareholder securities class action complaint captioned MARTIN H. SIEGEL v. SKECHERS USA, INC. et al. was filed against the Company and certain of its officers and directors in the United States District Court for the Central District of California (Case No 03-2645 RMT). On May 6, 2003, a shareholder securities class action complaint captioned ADAM D. SAPHIER v. SKECHERS USA, INC. et al. was served on the Company and certain of its officers and directors in the United States District Court for the Central District of California (Case No. 03-3011 FMC). On May 9, 2003, a shareholders securities class action complaint captioned LARRY L. ERICKSON v. SKECHERS USA, INC. et al. was served on the Company and certain of its officers and directors in the United States District Court for the Central District of California (Case No. 03-3101 SJO). Each of these class action complaints alleged violations of the federal securities laws on behalf of persons who purchased publicly traded securities of the Company between April 3, 2002 and December 9, 2002. In July 2003, the court in these federal securities class actions, all pending in the United States District Court for the Central District of California, ordered the cases consolidated and a consolidated complaint to be filed and served. On September 25, 2003, the plaintiffs filed a consolidated complaint entitled In re SKECHERS USA, Inc. Securities Litigation, Case No. CV-03-2094-PA in the United States District Court for the Central District of California, consolidating all of the federal securities actions above. The complaint names as defendants the Company and certain officers and directors and alleges violations of the federal securities laws and breach of fiduciary duty on behalf of persons who purchased publicly traded securities of the Company between April 3, 2002 and December 9, 2002. The complaint seeks compensatory damages, interest, attorneys' fees and injunctive and equitable relief. The Company moved to dismiss the consolidated complaint in its entirety. On May 10, 2004, the court granted the Company's motion to dismiss with leave for plaintiffs to amend the complaint. On August 9, 2004, plaintiffs filed a first amended consolidated complaint for violations of the federal securities laws. The allegations and relief sought were virtually identical to the original consolidated complaint. The Company has moved to dismiss the first amended consolidated complaint and the motion was set for hearing on December 6, 2004. On March 21, 2005, the court granted the motion to dismiss the first amended consolidated complaint with leave for plaintiffs to amend one final time. On April 7, 2005, plaintiffs elected to stand on the first amended consolidated complaint and requested entry of judgment so that an appeal from the court's ruling could be taken. On April 26, 2005, the court entered judgment in favor of the Company and the individual defendants, and on May 3, 2005, plaintiffs filed an appeal with the United States Court of Appeals for the Ninth Circuit. As of the filing date of the Company's quarterly report for the first quarter of 2007, all briefing by the parties had been completed, and a hearing date had been scheduled for April 18, 2007, but the court took it off calendar pending a decision from the United States Supreme Court in another matter on the grounds that the decision from the Supreme Court could affect the outcome of the appeal. The United States Supreme Court handed down its decision in that matter on September 20, 2007. The parties prepared briefs based on that decision and oral arguments were presented before the Ninth Circuit on November 6, 2007. Discovery has not commenced in the underlying action. While it is too early to predict the outcome of the appeal and any subsequent litigation, the Company continues to believe the suit is without merit and continues to vigorously defend against the claims.

On March 15, 2007, the Company filed a lawsuit against Vans, Inc. in the U.S. District Court for the Central District of California (Case No. CV 07-10703 (PLA)) seeking a declaration, inter alia, that certain of its footwear designs do not infringe Vans' claimed checkerboard design and waffle outsole design trademarks. On April 4, 2007, in its answer to the Company's complaint, Vans filed counter-claims and cross-claims against the Company and Ecco Unlimited, Inc., respectively, for trademark infringement, trademark dilution, unfair competition and misappropriation. Vans is seeking, inter alia, compensatory, treble and punitive damages, profits, attorneys' fees and costs, and injunctive relief against the Company to prevent any future sales and distribution of footwear that allegedly

bears a design similar to Vans checkerboard design or waffle outsole design. On November 20, 2007, the court denied Vans preliminary injunction, and Vans appealed this ruling on December 20, 2007. While it is too early to predict the outcome of the litigation, the Company believes that it has meritorious defenses to the claims asserted by Vans and intends to defend against those claims vigorously.

The Company has no reason to believe that any liability with respect to pending legal actions, individually or in the aggregate, will have a material adverse effect on the Company's consolidated financial statements or results of operations. The Company occasionally becomes involved in litigation arising from the normal course of business, and management is unable to determine the extent of any liability that may arise from unanticipated future litigation.

**Table of Contents****(d) Product and Other Financing**

The Company finances production activities in part through the use of interest-bearing open purchase arrangements with certain of its international manufacturers. These arrangements currently bear interest at rates between 0% and 1.5% per 30 to 60 day term. The amounts outstanding under these arrangements at December 31, 2007 and 2006 were \$81.3 million and \$85.0 million, respectively, which are included in accounts payable in the accompanying consolidated balance sheets. Interest expense incurred by the Company under these arrangements amounted to \$3.3 million in 2007, \$2.9 million in 2006, and \$2.3 million in 2005. The Company has contractual commitments relating to licensing arrangements of \$41.1 million through 2012 and open purchase commitments with our foreign manufacturers of \$148.7 million which are not included in the accompanying consolidated balance sheets. The company is currently in the process of designing and purchasing the equipment to be used in its new distribution center. The total cost of this equipment is expected to be between \$75.0 million and \$85.0 million.

**(e) Tax Contingencies**

See discussion regarding the liability for unrecognized tax benefits in Footnote 10 Income Taxes.

**(14) SEGMENT INFORMATION**

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

|                         | <b>2007</b>  | <b>2006</b>  | <b>2005</b>  |
|-------------------------|--------------|--------------|--------------|
| Net sales               |              |              |              |
| Domestic wholesale      | \$ 831,235   | \$ 772,920   | \$ 634,294   |
| International wholesale | 267,648      | 183,687      | 163,523      |
| Retail                  | 279,361      | 237,390      | 201,610      |
| E-commerce              | 15,937       | 11,371       | 7,050        |
| Total                   | \$ 1,394,181 | \$ 1,205,368 | \$ 1,006,477 |

|                         | <b>2007</b> | <b>2006</b> | <b>2005</b> |
|-------------------------|-------------|-------------|-------------|
| Gross profit            |             |             |             |
| Domestic wholesale      | \$ 320,364  | \$ 301,215  | \$ 232,401  |
| International wholesale | 99,759      | 65,034      | 60,758      |
| Retail                  | 171,758     | 151,456     | 123,928     |
| E-commerce              | 8,108       | 5,641       | 3,395       |
| Total                   | \$ 599,989  | \$ 523,346  | \$ 420,482  |

|                         | <b>2007</b> | <b>2006</b> |
|-------------------------|-------------|-------------|
| Identifiable assets     |             |             |
| Domestic wholesale      | \$ 629,377  | \$ 563,956  |
| International wholesale | 118,195     | 108,210     |
| Retail                  | 80,250      | 64,634      |
| E-commerce              | 155         | 253         |
| Total                   | \$ 827,977  | \$ 737,053  |



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|                                            | <b>2007</b> | <b>2006</b> |
|--------------------------------------------|-------------|-------------|
| Additions to property, plant and equipment |             |             |
| Domestic wholesale                         | \$ 11,371   | \$ 17,453   |
| International wholesale                    | 1,346       | 348         |
| Retail                                     | 18,458      | 9,759       |
| Total                                      | \$ 31,175   | \$ 27,560   |

## Geographic Information

The following summarizes our operations in different geographic areas for the year indicated:

|                         | <b>2007</b>  | <b>2006</b>  | <b>2005</b>  |
|-------------------------|--------------|--------------|--------------|
| Net Sales (1)           |              |              |              |
| United States           | \$ 1,102,895 | \$ 1,002,022 | \$ 826,920   |
| Canada                  | 38,060       | 25,276       | 18,350       |
| Other International (2) | 253,226      | 178,070      | 161,207      |
| Total                   | \$ 1,394,181 | \$ 1,205,368 | \$ 1,006,477 |

|                         | <b>2007</b> | <b>2006</b> |
|-------------------------|-------------|-------------|
| Long-lived Assets       |             |             |
| United States           | \$ 96,044   | \$ 81,161   |
| Canada                  | 343         | 764         |
| Other International (2) | 2,013       | 5,720       |
| Total                   | \$ 98,400   | \$ 87,645   |

(1) The Company has subsidiaries in Canada, United Kingdom, Germany, France, Spain, Italy, Netherlands, Brazil, Thailand and Malaysia that generate net sales within those respective countries and in some cases the neighboring regions. The Company also

has a subsidiary in Switzerland that generates net sales from that country in addition to net sales to our distributors located in numerous non-European countries. Net sales are attributable to geographic regions based on the location of the Company subsidiary.

- (2) Other international consists of Brazil, Malaysia, Thailand, Switzerland, United Kingdom, Germany, France, Spain, Italy, and Netherlands.

#### **(15) RELATED PARTY TRANSACTIONS**

The Company paid approximately \$175,000, \$177,000 and \$47,000 during 2007, 2006 and 2005, respectively, to the Manhattan Inn Operating Company, LLC ( MIOC ) for lodging, food and events including the Company's holiday party at the Shade Hotel, which is owned and operated by MIOC. Michael Greenberg, President and a director of the Company, owns a 12% beneficial ownership interest in MIOC, and four other officers, directors and vice presidents of the Company own in aggregate an additional 5% beneficial ownership in MIOC. The Company had no outstanding accounts receivable or payable with MIOC or the Shade Hotel at December 31, 2007.

The Company had receivables from officers and employees of \$0.3 million and \$0.5 million at December 31, 2007 and 2006, respectively. These amounts primarily relate to travel advances and incidental personal purchases on Company-issued credit cards that are not business-related expenses. These receivables are short-term and are expected to be repaid within a reasonable period of time.

We had no other significant transactions with or payables to officers, directors or significant shareholders of the Company.

**Table of Contents****(16) SUMMARY OF QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

Summarized unaudited financial data are as follows (in thousands):

|              | <b>2007</b> | <b>MARCH 31</b> | <b>JUNE 30</b> | <b>SEPTEMBER 30</b> | <b>DECEMBER 31</b> |
|--------------|-------------|-----------------|----------------|---------------------|--------------------|
| Net sales    |             | \$344,896       | \$352,211      | \$ 395,033          | \$ 302,041         |
| Gross profit |             | 149,039         | 152,028        | 171,670             | 127,252            |
| Net earnings |             | 23,900          | 14,948         | 24,744              | 12,095             |

Net earnings per share:

|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | \$ 0.54 | \$ 0.33 | \$ 0.54 | \$ 0.26 |
| Diluted | 0.52    | 0.32    | 0.53    | 0.26    |

|              | <b>2006</b> | <b>MARCH 31</b> | <b>JUNE 30</b> | <b>SEPTEMBER 30</b> | <b>DECEMBER 31</b> |
|--------------|-------------|-----------------|----------------|---------------------|--------------------|
| Net sales    |             | \$277,565       | \$292,183      | \$ 331,126          | \$ 304,494         |
| Gross profit |             | 118,374         | 130,736        | 146,303             | 127,933            |
| Net earnings |             | 16,598          | 17,616         | 22,199              | 14,582             |

Net earnings per share:

|         |         |         |         |         |
|---------|---------|---------|---------|---------|
| Basic   | \$ 0.41 | \$ 0.43 | \$ 0.54 | \$ 0.35 |
| Diluted | 0.38    | 0.40    | 0.49    | 0.33    |

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

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

**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

The term disclosure controls and procedures refers to the controls and other procedures of a company that are designed to provide reasonable assurance that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported within required time periods. We have established disclosure controls and procedures to ensure that material information relating to Skechers and its consolidated subsidiaries is made known to the officers who certify our financial reports, as well as other members of senior management and the Board of Directors, to allow timely decisions regarding required disclosures. As of the end of the period covered by this annual report on Form 10-K, we carried out an evaluation under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based upon that evaluation, our CEO and CFO concluded that our disclosure controls and procedures are effective.

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Internal control over financial reporting includes those policies and procedures that (i)



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pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

We conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation under the framework in *Internal Control- Integrated Framework*, our management has concluded that as of December 31, 2007, our internal control over financial reporting is effective.

Our independent registered public accountants, KPMG LLP, audited the financial statements included in this annual report on Form 10-K and have issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2007, which is included in Part II, Item 8 of this annual report on Form 10-K.

### **INHERENT LIMITATIONS ON EFFECTIVENESS OF CONTROLS**

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

### **CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

There were no significant changes to our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting during the fourth quarter of 2007, we have completed our efforts regarding compliance with Section 404 of the Sarbanes-Oxley Act of 2002 for the year ended December 31, 2007. The results of our evaluation are discussed above in Management's Report on Internal Control Over Financial Reporting.

### **ITEM 9B. OTHER INFORMATION**

On January 18, 2008, our Compensation Committee approved the 2008 annual incentive compensation formulae for our executive management, including the Named Executive Officers (as defined in Item 402 of Regulation S-K), which will allow for executive management to earn incentive compensation on a quarterly basis in the event that certain specified performance goals are achieved under our 2006 Annual Incentive Compensation Plan (the 2006 Plan). The purpose is to provide our executive management with the opportunity to earn incentive compensation based on our financial performance by linking incentive award opportunities to the achievement of certain performance goals.

The Compensation Committee approved the business criteria to be used in the formulae to calculate the incentive compensation to be paid to our executive management on a quarterly basis for 2008. The business criteria that will be used to calculate the incentive compensation of Robert Greenberg (Chairman and Chief Executive Officer), Michael Greenberg (President), David Weinberg (Chief Operating Officer) and Mark Nason (Executive Vice President of Product Development) are our net sales and net earnings, while our net sales will be used for calculating the incentive

compensation of Fred Schneider (Chief Financial Officer). The Compensation Committee believes that each of these criteria provides an accurate and comprehensive measure of our annual performance.

The potential payments of incentive compensation to our executive management, including the Named Executive Officers, are performance-driven and therefore completely at risk. The payment of any incentive compensation is conditioned on our company

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achieving at least certain threshold performance levels of the business criteria approved by the Compensation Committee, and no payments will be made to the Named Executive Officers if the threshold performance levels are not met. Any incentive compensation to be paid to the Named Executive Officers in excess of the threshold amounts are based on the Compensation Committee's pre-approved business criteria and formulae for the respective Named Executive Officers. In approving the percentages that will be used in the formulae to calculate the Named Executive Officers' potential payments of incentive compensation for 2008, the Compensation Committee considered each Named Executive Officer's position, responsibilities and prospective contribution to the attainment of the Company's specified performance goals. The threshold performance levels for 2008 are attainable, and additional incentive compensation may be earned based on our company's financial performance exceeding increasingly challenging levels of performance goals, none of which is certain to be achieved. Consistent with the prior year, the Compensation Committee did not place a maximum limit on the incentive compensation that may be earned by the Named Executive Officers in 2008, although the maximum amount of incentive compensation that any Named Executive Officer may earn in a 12-month period under the 2006 Plan is \$5,000,000.

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**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information required by this Item 10 is hereby incorporated by reference from our definitive proxy statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2007 fiscal year.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this Item 11 is hereby incorporated by reference from our definitive proxy statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2007 fiscal year.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this Item 12 is hereby incorporated by reference from our definitive proxy statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2007 fiscal year.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this Item 13 is hereby incorporated by reference from our definitive proxy statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2007 fiscal year.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this Item 14 is hereby incorporated by reference from our definitive proxy statement, to be filed pursuant to Regulation 14A within 120 days after the end of our 2007 fiscal year.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

1. Financial Statements: See Index to Consolidated Financial Statements and Financial Statement Schedule in Part II, Item 8 on page 36 of this annual report on Form 10-K.
2. Financial Statement Schedule: See Schedule II Valuation and Qualifying Accounts on page 64 of this annual report on Form 10-K.
3. Exhibits: The exhibits listed in the accompanying Index to Exhibits are filed or incorporated by reference as part of this Form 10-K.

Table of Contents**SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS****(in thousands)****Years Ended December 31, 2007, 2006 and 2005**

| <b>DESCRIPTION</b>                       | <b>BALANCE<br/>AT<br/>BEGINNING<br/>OF<br/>PERIOD</b> | <b>CHARGED<br/>TO<br/>COSTS AND<br/>EXPENSES</b> | <b>DEDUCTIONS<br/>AND<br/>WRITE-OFFS</b> | <b>BALANCE<br/>AT END<br/>OF<br/>PERIOD</b> |
|------------------------------------------|-------------------------------------------------------|--------------------------------------------------|------------------------------------------|---------------------------------------------|
| Year-ended December 31, 2005:            |                                                       |                                                  |                                          |                                             |
| Allowance for chargebacks                | \$ 578                                                | \$ 368                                           | \$ (323)                                 | \$ 623                                      |
| Allowance for doubtful accounts          | 1,887                                                 | 870                                              | (792)                                    | 1,965                                       |
| Reserve for sales returns and allowances | 3,578                                                 | 1,644                                            | (614)                                    | 4,608                                       |
| Year-ended December 31, 2006:            |                                                       |                                                  |                                          |                                             |
| Allowance for chargebacks                | \$ 623                                                | \$ 1,237                                         | \$ (359)                                 | \$ 1,501                                    |
| Allowance for doubtful accounts          | 1,965                                                 | 1,307                                            | (573)                                    | 2,699                                       |
| Reserve for sales returns and allowances | 4,608                                                 | 2,047                                            | (297)                                    | 6,358                                       |
| Year-ended December 31, 2007:            |                                                       |                                                  |                                          |                                             |
| Allowance for chargebacks                | \$ 1,501                                              | \$ 1,684                                         | \$ (613)                                 | \$ 2,572                                    |
| Allowance for doubtful accounts          | 2,699                                                 | 284                                              | (635)                                    | 2,348                                       |
| Reserve for sales returns and allowances | 6,358                                                 | (358)                                            | (636)                                    | 5,364                                       |

See accompanying report of independent registered public accounting firm

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**INDEX TO EXHIBITS**

**EXHIBIT  
NUMBER**

**DESCRIPTION OF EXHIBIT**

- |           |                                                                                                                                                                                                                                                                                                          |
|-----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1       | Amended and Restated Certificate of Incorporation dated April 29, 1999 (incorporated by reference to exhibit number 3.1 of the Registrant's Registration Statement on Form S-1, as amended (File No. 333-60065), filed with the Securities and Exchange Commission on May 12, 1999).                     |
| 3.2       | Bylaws dated May 28, 1998 (incorporated by reference to exhibit number 3.2 of the Registrant's Registration Statement on Form S-1 (File No. 333-60065) filed with the Securities and Exchange Commission on July 29, 1998).                                                                              |
| 3.2(a)    | Amendment to Bylaws dated as of April 8, 1999 (incorporated by reference to exhibit number 3.2(a) of the Registrant's Form 10-K for the year ended December 31, 2005).                                                                                                                                   |
| 3.2(b)    | Second Amendment to Bylaws dated as of December 18, 2007 (incorporated by reference to exhibit number 3.1 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on December 20, 2007).                                                                                          |
| 4.1       | Form of Specimen Class A Common Stock Certificate (incorporated by reference to exhibit number 4.1 of the Registrant's Registration Statement on Form S-1, as amended (File No. 333-60065), filed with the Securities and Exchange Commission on May 12, 1999).                                          |
| 4.2       | Indenture, dated April 9, 2002, between the Registrant and Wells Fargo Bank, National Association, as Trustee, relating to the 4.5% Convertible Subordinated Notes (incorporated by reference to exhibit number 4.2 of the Registrant's Form 10-Q for the quarter ended June 30, 2002).                  |
| 4.3       | Form of Specimen Restricted Global Security (incorporated by reference to exhibit number 4.3 of the Registrant's Form 10-Q for the quarter ended June 30, 2002).                                                                                                                                         |
| 10.1**    | Amended and Restated 1998 Stock Option, Deferred Stock and Restricted Stock Plan (incorporated by reference to exhibit number 10.1 of the Registrant's Registration Statement on Form S-1 (File No. 333-60065) filed with the Securities and Exchange Commission on July 29, 1998).                      |
| 10.1(a)** | Amendment No. 1 to Amended and Restated 1998 Stock Option, Deferred Stock and Restricted Stock Plan (incorporated by reference to exhibit number 4.4 of the Registrant's Registration Statement on Form S-8 (File No. 333-71114), filed with the Securities and Exchange Commission on October 5, 2001). |
| 10.1(b)** | Amendment No. 2 to Amended and Restated 1998 Stock Option, Deferred Stock and Restricted Stock Plan (incorporated by reference to exhibit number 4.5 of the Registrant's Registration Statement on Form S-8 (File No. 333-135049), filed with the Securities and Exchange Commission on June 15, 2006).  |
| 10.1(c)** | Amendment No. 3 to Amended and Restated 1998 Stock Option, Deferred Stock and Restricted Stock Plan (incorporated by reference to exhibit number 10.1 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on February 23, 2007).                                              |
| 10.2**    |                                                                                                                                                                                                                                                                                                          |

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2007 Incentive Award Plan (incorporated by reference to exhibit number 10.1 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on May 24, 2007).

10.3\*\* Form of Restricted Stock Agreement under 2007 Incentive Award Plan.

10.4\*\* 2008 Employee Stock Purchase Plan (incorporated by reference to exhibit number 10.2 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on May 24, 2007).

10.5\*\* 2006 Annual Incentive Compensation Plan (incorporated by reference to Appendix A of the Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on May 1, 2006).

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**EXHIBIT  
NUMBER**

**DESCRIPTION OF EXHIBIT**

|           |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|-----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.6**    | Indemnification Agreement dated June 7, 1999 between the Registrant and its directors and executive officers (incorporated by reference to exhibit number 10.6 of the Registrant's Form 10-K for the year ended December 31, 1999).                                                                                                                                                                                                                                                                                     |
| 10.6(a)** | List of Registrant's directors and executive officers who entered into Indemnification Agreement referenced in Exhibit 10.6 with the Registrant (incorporated by reference to exhibit number 10.6(a) of the Registrant's Form 10-K for the year ended December 31, 2005).                                                                                                                                                                                                                                               |
| 10.7      | Registration Rights Agreement dated June 9, 1999, between the Registrant, the Greenberg Family Trust and Michael Greenberg (incorporated by reference to exhibit number 10.7 of the Registrant's Form 10-Q for the quarter ended June 30, 1999).                                                                                                                                                                                                                                                                        |
| 10.8      | Tax Indemnification Agreement dated June 8, 1999, between the Registrant and certain shareholders (incorporated by reference to exhibit number 10.8 of the Registrant's Form 10-Q for the quarter ended June 30, 1999).                                                                                                                                                                                                                                                                                                 |
| 10.9      | Second Amended and Restated Loan and Security Agreement, dated May 31, 2006, by and among the Registrant and certain of its subsidiaries that are also borrowers under the Agreement, certain of its subsidiaries who are guarantors under the Agreement, and certain lenders including The CIT Group/Commercial Services, Inc., which acts as agent for the lenders (incorporated by reference to exhibit number 10.1 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on June 6, 2006). |
| 10.10     | Promissory Note, dated December 27, 2000, between the Registrant and Washington Mutual Bank, FA, for the purchase of property located at 225 South Sepulveda Boulevard, Manhattan Beach, California (incorporated by reference to exhibit number 10.23 of the Registrant's Form 10-K for the year ended December 31, 2000).                                                                                                                                                                                             |
| 10.11     | Loan Agreement, dated December 21, 2000, between Yale Investments, LLC, and MONY Life Insurance Company, for the purchase of property located at 1670 South Champagne Avenue, Ontario, California (incorporated by reference to exhibit number 10.25 of the Registrant's Form 10-K for the year ended December 31, 2000).                                                                                                                                                                                               |
| 10.12     | Promissory Note, dated December 21, 2000, between Yale Investments, LLC, and MONY Life Insurance Company, for the purchase of property located at 1670 Champagne Avenue, Ontario, California (incorporated by reference to exhibit number 10.26 of the Registrant's Form 10-K for the year ended December 31, 2000).                                                                                                                                                                                                    |
| 10.13     | Agreement dated August 25, 2005 between Duncan Investments, LLC, a wholly owned subsidiary of the Registrant, and Morley Construction Company regarding 330 South Sepulveda Boulevard, Manhattan Beach, California (incorporated by reference to exhibit number 10.1 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on August 29, 2005).                                                                                                                                                |
| 10.14     | General Conditions of the Contract for Construction regarding 330 South Sepulveda Boulevard, Manhattan Beach, California (incorporated by reference to exhibit number 10.2 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on August 29, 2005).                                                                                                                                                                                                                                          |



- 10.15 Lease Agreement, dated November 21, 1997, between the Registrant and The Prudential Insurance Company of America, regarding 1661 South Vintage Avenue, Ontario, California (incorporated by reference to exhibit number 10.14 of the Registrant's Registration Statement on Form S-1 (File No. 333-60065) filed with the Securities and Exchange Commission on July 29, 1998).
- 10.15(a) First Amendment to Lease Agreement, dated April 26, 2002, between the Registrant and ProLogis California I LLC, regarding 1661 South Vintage Avenue, Ontario, California (incorporated by reference to exhibit number 10.14(a) of the Registrant's Form 10-K for the year ended December 21, 2002).
- 10.15(b) Second Amendment to Lease Agreement, dated December 10, 2007, between the Registrant and ProLogis California I LLC, regarding 1661 South Vintage Avenue, Ontario, California.

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**EXHIBIT  
NUMBER**

**DESCRIPTION OF EXHIBIT**

|          |                                                                                                                                                                                                                                                                                                                                                                                |
|----------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.16    | Lease Agreement, dated November 21, 1997, between the Registrant and The Prudential Insurance Company of America, regarding 1777 South Vintage Avenue, Ontario, California (incorporated by reference to exhibit number 10.15 of the Registrant's Registration Statement on Form S-1 (File No. 333-60065) filed with the Securities and Exchange Commission on July 29, 1998). |
| 10.16(a) | First Amendment to Lease Agreement, dated April 26, 2002, between the Registrant and Cabot Industrial Properties, L.P., regarding 1777 South Vintage Avenue, Ontario, California (incorporated by reference to exhibit number 10.15(a) of the Registrant's Form 10-K for the year ended December 21, 2002).                                                                    |
| 10.16(b) | Second Amendment to Lease Agreement, dated May 14, 2002, between the Registrant and Cabot Industrial Properties, L.P., regarding 1777 South Vintage Avenue, Ontario, California.                                                                                                                                                                                               |
| 10.16(c) | Third Amendment to Lease Agreement, dated May 7, 2007, between the Registrant and Cabot Industrial Properties, L.P., regarding 1777 South Vintage Avenue, Ontario, California.                                                                                                                                                                                                 |
| 10.16(d) | Fourth Amendment to Lease Agreement, dated November 10, 2007, between the Registrant and Cabot Industrial Properties, L.P., regarding 1777 South Vintage Avenue, Ontario, California.                                                                                                                                                                                          |
| 10.17    | Lease Agreement, dated April 10, 2001, between the Registrant and ProLogis California I LLC, regarding 4100 East Mission Boulevard, Ontario, California (incorporated by reference to exhibit number 10.28 of the Registrant's Form 10-K for the year ended December 31, 2001).                                                                                                |
| 10.17(a) | First Amendment to Lease Agreement, dated October 22, 2003, between the Registrant and ProLogis California I LLC, regarding 4100 East Mission Boulevard, Ontario, California (incorporated by reference to exhibit number 10.28(a) of the Registrant's Form 10-K for the year ended December 31, 2003).                                                                        |
| 10.18    | Lease Agreement, dated February 8, 2002, between Skechers International, a subsidiary of the Registrant, and ProLogis Belgium II SPRL, regarding ProLogis Park Liege Distribution Center I in Liege, Belgium (incorporated by reference to exhibit number 10.29 of the Registrant's Form 10-K for the year ended December 31, 2002).                                           |
| 10.19    | Lease Agreement dated September 25, 2007 between the Registrant and HF Logistics I, LLC, regarding distribution facility in Moreno Valley, California (incorporated by reference to exhibit number 10.1 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on September 27, 2007).                                                                 |
| 10.20**  | Amended and Restated 1998 Employee Stock Purchase Plan (incorporated by reference to exhibit number 10.1 of the Registrant's Form 10-Q, for the quarter ended June 30, 2000).                                                                                                                                                                                                  |
| 21.1     | Subsidiaries of the Registrant.                                                                                                                                                                                                                                                                                                                                                |
| 23.1     | Consent of Independent Registered Public Accounting Firm.                                                                                                                                                                                                                                                                                                                      |
| 31.1     | Certification of the Chief Executive Officer pursuant Securities Exchange Act Rule 13a-14(a).                                                                                                                                                                                                                                                                                  |

- 31.2 Certification of the Chief Financial Officer pursuant Securities Exchange Act Rule 13a-14(a).
- 32.1 Certification pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\*\* Management  
contract or  
compensatory  
plan or  
arrangement  
required to be  
filed as an  
exhibit.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of Manhattan Beach, State of California on the 29th day of February 2008.

SKECHERS U.S.A., INC.

By: /S/ ROBERT GREENBERG  
Robert Greenberg  
Chairman of the Board and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| <b>SIGNATURE</b>                                            | <b>TITLE</b>                                                            | <b>DATE</b>       |
|-------------------------------------------------------------|-------------------------------------------------------------------------|-------------------|
| /S/ ROBERT GREENBERG<br><br>Robert Greenberg                | Chief Executive Officer<br>(Principal Executive Officer)                | February 29, 2008 |
| /S/ MICHAEL GREENBERG<br><br>Michael Greenberg              | President and Director                                                  | February 29, 2008 |
| /S/ DAVID WEINBERG<br><br>David Weinberg                    | Executive Vice President, Chief Operating<br>Officer and Director       | February 29, 2008 |
| /S/ FREDERICK H.<br>SCHNEIDER<br><br>Frederick H. Schneider | Chief Financial Officer<br>(Principal Financial and Accounting Officer) | February 29, 2008 |
| /S/ JEFFREY GREENBERG<br><br>Jeffrey Greenberg              | Director                                                                | February 29, 2008 |
| /S/ J. GEYER KOSINSKI<br><br>J. Geyer Kosinski              | Director                                                                | February 29, 2008 |
| /S/ MORTON D. ERLICH<br><br>Morton D. Erlich                | Director                                                                | February 29, 2008 |
| /S/ RICHARD SISKIND                                         | Director                                                                | February 29, 2008 |

Richard Siskind

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