SKECHERS USA INC
Form 10-Q
August 04, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the transition period from ____ to____

Commission File Number 001-14429

SKECHERS U.S.A., INC.

(Exact name of registrant as specified in its charter)

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

228 Manhattan Beach Blvd.

Manhattan Beach, California	90266
(Address of Principal Executive Office)	(Zip Code)

(310) 318-3100

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a small reporting company)	Smaller reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

THE NUMBER OF SHARES OF CLASS A COMMON STOCK OUTSTANDING AS OF AUGUST 1, 2017: 133,885,844.

THE NUMBER OF SHARES OF CLASS B COMMON STOCK OUTSTANDING AS OF AUGUST 1, 2017: 24,545,188.

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

FORM 10-Q

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PART I – FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par values)

	June 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$751,581	$718,536
Trade accounts receivable, less allowances of $49,107 in 2017 and $41,647 in 2016	494,683	326,844
Other receivables	24,884	19,191
Total receivables	519,567	346,035
Inventories	669,741	700,515
Prepaid expenses and other current assets	54,119	62,680
Total current assets	1,995,008	1,827,766
Property, plant and equipment, net	527,441	494,473
Deferred tax assets	33,517	26,043
Other assets, net	53,324	45,388
Total non-current assets	614,282	565,904
TOTAL ASSETS	$2,609,290	$2,393,670
LIABILITIES AND EQUITY		
Current liabilities:		
Current installments of long-term borrowings	$1,792	$1,783
Short-term borrowings	4,049	6,086
Accounts payable	528,251	520,437
Accrued expenses	101,518	93,424
Total current liabilities	635,610	621,730
Long-term borrowings, excluding current installments	68,271	67,159
Deferred tax liabilities	417	412
Other long-term liabilities	21,734	18,855
Total non-current liabilities	90,422	86,426
Total liabilities	726,032	708,156
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock, $0.001 par value; 10,000 shares authorized; none issued and outstanding	—	—
Class A common stock, $0.001 par value; 500,000 shares authorized;	131	130

131,259 and 130,386 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively		
Class B convertible common stock, $0.001 par value; 75,000 shares authorized; 24,545 shares issued and outstanding at June 30, 2017 and December 31, 2016	24	24
Additional paid-in capital	436,296	419,038
Accumulated other comprehensive loss	(21,929)	(26,604)
Retained earnings	1,364,575	1,211,045
Skechers U.S.A., Inc. equity	1,779,097	1,603,633
Non-controlling interests	104,161	81,881
Total stockholders' equity	1,883,258	1,685,514
TOTAL LIABILITIES AND EQUITY	$2,609,290	$2,393,670

See accompanying notes to unaudited condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net sales	$1,025,934	$877,810	$2,098,742	$1,856,604
Cost of sales	537,613	461,556	1,133,923	1,008,198
Gross profit	488,321	416,254	964,819	848,406
Royalty income	3,221	3,307	7,451	5,932
	491,542	419,561	972,270	854,338
Operating expenses:				
Selling	99,950	75,966	173,759	129,844
General and administrative	305,283	243,240	587,779	485,589
	405,233	319,206	761,538	615,433
Earnings from operations	86,309	100,355	210,732	238,905
Other income (expense):				
Interest income	381	319	794	585
Interest expense	(1,845)	(1,861)	(3,334)	(3,249)
Other, net	2,664	(2,604)	3,359	175
Total other income (expense)	1,200	(4,146)	819	(2,489)
Earnings before income tax expense	87,509	96,209	211,551	236,416
Income tax expense	14,109	12,200	31,516	42,768
Net earnings	73,400	84,009	180,035	193,648
Less: Net earnings attributable to non-controlling interests	13,865	9,902	26,505	21,929
Net earnings attributable to Skechers U.S.A., Inc.	$59,535	$74,107	$153,530	$171,719
Net earnings per share attributable to Skechers U.S.A., Inc.:				
Basic	$0.38	$0.48	$0.99	$1.12
Diluted	$0.38	$0.48	$0.98	$1.11
Weighted average shares used in calculating net earnings per share attributable to Skechers U.S.A, Inc.:				
Basic	155,579	154,049	155,340	153,901
Diluted	156,174	155,023	156,016	154,912

See accompanying notes to unaudited condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENTS OF

COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net earnings	$73,400	$84,009	$180,035	$193,648
Other comprehensive income, net of tax:				
Gain on foreign currency translation adjustment	2,574	338	7,156	6,336
Comprehensive income	75,974	84,347	187,191	199,984
Less: Comprehensive income attributable to non-controlling interests	14,663	8,353	28,987	21,326
Comprehensive income attributable to Skechers U.S.A., Inc.	$61,311	$75,994	$158,204	$178,658

See accompanying notes to unaudited condensed consolidated financial statements.

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

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30, 2017	2016
Cash flows from operating activities:		
Net earnings	$180,035	$193,648
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization of property, plant and equipment	38,693	30,555
Amortization of other assets	6,878	5,820
Provision for bad debts and returns	11,252	8,385
Non-cash share-based compensation	14,248	10,870
Deferred income taxes	(7,498)	692
Loss on non-current assets	665	557
Net foreign currency adjustments	(5,388)	(441)
(Increase) decrease in assets:		
Receivables	(178,308)	(130,707)
Inventories	34,467	33,789
Prepaid expenses and other current assets	3,672	(4,142)
Other assets	(5,986)	(3,867)
Increase (decrease) in liabilities:		
Accounts payable	6,119	54,213
Accrued expenses and other long-term liabilities	10,302	(17,090)
Net cash provided by operating activities	109,151	182,282
Cash flows from investing activities:		
Capital expenditures	(76,502)	(55,034)
Purchases of investments	(1,023)	(2,194)
Proceeds from sales of investments	240	131
Net cash used in investing activities	(77,285)	(57,097)
Cash flows from financing activities:		
Net proceeds from the issuances of common stock through the employee stock purchase plan	3,011	2,928
Payments on long-term debt	(944)	(14,768)
Proceeds from long-term debt	2,065	—
Net proceeds from (payments on) short-term borrowings	(2,296)	3,232
Excess tax benefits from share-based compensation	—	4,469
Distributions to non-controlling interests of consolidated entity	(6,753)	(5,199)
Contributions from non-controlling interests of consolidated entity	46	2,905
Net cash used in financing activities	(4,871)	(6,433)
Net increase in cash and cash equivalents	26,995	118,752

Effect of exchange rates on cash and cash equivalents	6,050	2,084
Cash and cash equivalents at beginning of the period	718,536	507,991
Cash and cash equivalents at end of the period	$751,581	$628,827
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$3,250	$3,041
Income taxes, net	36,334	34,391

See accompanying notes to unaudited condensed consolidated financial statements.

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2017 and 2016

(Unaudited)

(1) GENERAL

Basis of Presentation

The accompanying condensed consolidated financial statements of Skechers U.S.A., Inc. (the “Company”) have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”), for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S X. Accordingly, they do not include certain notes and financial presentations normally required under U.S. GAAP for complete financial reporting. The interim financial information is unaudited, but reflects all normal adjustments and accruals which are, in the opinion of management, considered necessary to provide a fair presentation for the interim periods presented. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

The results of operations for the six months ended June 30, 2017 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2017.

Inventories

Inventories, principally finished goods, are stated at the lower of cost (based on the first-in, first-out method) or market (net realizable value). Cost includes shipping and handling fees and costs, which are subsequently expensed to cost of sales. 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 on inventory on hand, historical sales activity, industry trends, the retail environment, and the expected net realizable value. The net realizable value is determined using estimated sales prices of similar inventory through off-price or discount store channels.

In July 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No 2015-11, “Inventory (Topic 330): Simplifying the Measurement of Inventory” (“ASU 2015-11”). ASU 2015-11 requires that inventory within the scope of this standard be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The amendments apply to inventory that is measured using first-in, first-out or average cost. Effective January 1, 2017, the Company adopted ASU 2015-11. The adoption of ASU 2015-11 did not have a material impact on the Company’s condensed consolidated financial statements.

Fair Value of Financial Instruments

The carrying amount of the Company’s financial instruments, which principally include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximates fair value because of the relatively short maturity of such instruments. The carrying amount of the Company’s short-term and long-term borrowings, which are considered Level 2 liabilities, approximates fair value based upon current rates and terms available to the Company for similar debt.

As of August 12, 2015, the Company entered into an interest rate swap agreement concurrent with refinancing its domestic distribution center construction loan (see Note 2). The fair value of the interest rate swap was determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipt was based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. To comply with U.S. GAAP, credit valuation adjustments were incorporated to appropriately reflect both the Company's nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. The majority of the inputs used to value the interest rate swap were within Level 2 of the fair value hierarchy. As of June 30, 2017 and December 31, 2016, the interest rate swap was a Level 2 derivative and was classified as other long-term liabilities on the Company's condensed consolidated balance sheets.

Use of Estimates

The preparation of the condensed consolidated financial statements, in conformity with U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ materially from those estimates.

Revenue Recognition

The Company recognizes revenue on wholesale sales when products are shipped and the customer takes title and assumes risk of loss, collection of the relevant receivable is reasonably assured, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. This generally occurs at time of shipment. 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. Sales and value added taxes collected from retail customers are excluded from reported revenues. Generally, wholesale customers do not have the right to return goods, the Company periodically decides to accept returns or provide customers with credits. Allowances for estimated returns, discounts, doubtful accounts and chargebacks are provided for when related revenue is recorded.

Royalty income is earned from licensing arrangements. Upon signing a new licensing agreement, the Company receives up-front fees, which are generally characterized as prepaid royalties. These fees are initially deferred and recognized as revenue when earned. The first calculated royalty payment is based on actual sales of the licensed product or, in some cases, minimum royalty payments. Typically, at each quarter-end, the Company receives correspondence from licensees indicating actual sales for the period, which is used to calculate and accrue the related royalties currently receivable based on the terms of the agreement.

Recent Accounting Pronouncements

In October 2016, the FASB issued ASU No. 2016-16, “Accounting for Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory” (“ASU 2016-16”). The standard requires that the income tax impact of intra-entity sales and transfers of property, except for inventory, be recognized when the transfer occurs. The standard will become effective for the Company’s annual and interim reporting periods beginning January 1, 2018 and will require any deferred taxes not yet recognized on intra-entity transfers to be recorded to retained earnings under a modified retrospective approach. Early adoption is permitted. The Company is currently evaluating the impact of ASU 2016-16; however at the current time the Company does not know what impact the adoption of this ASU will have on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016-15”), which eliminates the diversity in practice related to the classification of certain cash receipts and payments. ASU 2016-15 designates the appropriate cash flow classification, including requirements to allocate certain components of these cash receipts and payments among operating, investing and financing activities. The retrospective transition method, requiring adjustment to all comparative periods presented, is required unless it is impracticable for some of the amendments, in which case those amendments would be prospectively adopted as of the earliest date practicable. ASU 2016-15 is effective for the Company’s annual and interim reporting periods beginning January 1, 2018. The Company is currently evaluating the impact of ASU 2016-15; however at the current time the Company does not know what impact the adoption of this ASU will have on its consolidated financial statements.

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

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). The new standard requires lessees to recognize most leases on the balance sheet, which will increase lessees’ reported assets and liabilities. ASU 2016-02 is effective for the Company’s annual and interim reporting periods beginning January 1, 2019. ASU 2016-02 mandates a modified retrospective transition method. The Company is currently assessing the impact of the new standard on its consolidated financial statements, but anticipates an increase in assets and liabilities due to the recognition of the required right-of-use asset and corresponding liability for all lease obligations that are currently classified as operating leases, such as real estate leases for corporate headquarters, administrative offices, retail stores, showrooms, and distribution facilities, as well as additional disclosure on all of the Company’s lease obligations. The earnings statement recognition of lease expense is not expected to change materially from the current methodology.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). The updated guidance enhances the reporting model for financial instruments, which includes amendments to address aspects of recognition, measurement, presentation and disclosure. The update to the standard should be applied prospectively and is effective for the Company's annual and interim reporting periods beginning January 1, 2018. The Company is currently evaluating the impact of ASU 2016-01; however at the current time the Company does not expect that the adoption of this ASU will have a material impact on its consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09 "Revenue from Contracts with Customers", Accounting Standards Codification 606 ("ASC 606"). This amendment prescribes that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The amendment supersedes the revenue recognition requirements in ASC Topic 605, "Revenue Recognition," and most industry-specific guidance throughout the Industry Topics of the Codification. For the Company's annual and interim reporting periods the mandatory adoption date of ASC 606 is January 1, 2018, and there will be two methods of adoption allowed, either a full retrospective adoption or a modified retrospective adoption. In August 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 to the first quarter of 2018. In March 2016, April 2016, May 2016, December 2016, and May 2017 the FASB issued ASU 2016-08, ASU 2016-10, ASU 2016-12, ASU 2016-20, and ASU 2017-10, respectively, as clarifications to ASU 2014-09. ASU 2016-08 clarifies how to identify the unit of accounting for the principal versus agent evaluation, how to apply the control principle to certain types of arrangements, such as service transactions, and reframed the indicators in the guidance to focus on evidence that an entity is acting as a principal rather than as an agent. ASU 2016-10 clarifies the existing guidance on identifying performance obligations and licensing implementation. ASU 2016-12 adds practical expedients related to the transition for contract modifications and further defines a completed contract, clarifies the objective of the collectability assessment and how revenue is recognized if collectability is not probable, and when non-cash considerations should be measured. ASU 2016-20 corrects or improves guidance in 13 narrow focus aspects of the guidance. ASU 2017-10 clarifies that the grantor in a service concession arrangement is the operating entity's customer for purposes of revenue recognition. The effective dates for these ASUs are the same as the effective date for ASU No. 2014-09, for the Company's annual and interim periods beginning January 1, 2018. These ASU's also require enhanced disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows. The Company will adopt the new revenue standards in the first quarter of 2018. The Company expects to adopt this pronouncement using the modified retrospective method. The Company is still completing the assessment of the impact of these ASUs on its consolidated financial statements; however at the current time the Company does not expect that the adoption of these ASUs will have a material impact on its consolidated financial statements.

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

The Company had $4.6 million and $2.0 million of outstanding letters of credit as of June 30, 2017 and December 31, 2016, respectively, and approximately $4.0 million and $6.1 million in short-term borrowings as of June 30, 2017 and December 31, 2016, respectively.

Long-term borrowings at June 30, 2017 and December 31, 2016 are as follows (in thousands):

	2017	2016
Note payable to banks, due in monthly installments of $298.2	$67,331	$68,059
(includes principal and interest), variable-rate interest at		

3.23% per annum, secured by property, balloon payment of $62,843 due August 2020		
Note payable to Luen Thai Enterprise, Ltd., balloon payment of $2,010 due January 2021	2,010	—
Note payable to TCF Equipment Finance, Inc., due in monthly installments of $30.5 (includes principal and interest), fixed-rate interest at 5.24% per annum, due July 2019	722	883
Subtotal	70,063	68,942
Less current installments	1,792	1,783
Total long-term borrowings	$68,271	$67,159

The Company’s long-term debt obligations contain both financial and non-financial covenants, including cross-default provisions. The Company is in compliance with its non-financial covenants, including any cross-default provisions, and financial covenants of its long-term borrowings as of June 30, 2017.

On June 30, 2015, the Company entered into a $250.0 million loan and security agreement, subject to increase by up to $100.0 million, (the “Credit Agreement”), with the following lenders: Bank of America, N.A., MUFG Union Bank, N.A. and HSBC Bank USA, National Association. The Credit Agreement matures on June 30, 2020. The Credit Agreement replaces the credit agreement dated June 30, 2009, which expired on June 30, 2015. The Credit Agreement permits the Company and certain of its subsidiaries to borrow based on a percentage of eligible accounts receivable plus the sum of (a) the lesser of (i) a percentage of eligible inventory to be sold at wholesale and (ii) a percentage of net orderly liquidation value of eligible inventory to be sold at wholesale, plus (b) the lesser of (i) a percentage of the value of eligible inventory to be sold at retail and (ii) a percentage of net orderly liquidation value of eligible inventory to be sold at retail, plus (c) the lesser of (i) a percentage of the value of eligible in-transit inventory and (ii) a percentage of the net orderly liquidation value of eligible in-transit inventory. Borrowings bear interest at the Company’s election based on (a) LIBOR or (b) the greater of (i) the Prime Rate, (ii) the Federal Funds Rate plus 0.5% and (iii) LIBOR for a 30-day period plus 1.0%, in each case, plus an applicable margin based on the average daily principal balance of revolving loans available under the Credit Agreement. The Company pays a monthly unused line of credit fee of 0.25%, payable on the first day of each month in arrears, which is based on the average daily principal balance of outstanding revolving loans and undrawn amounts of letters of credit outstanding during such month. The Credit Agreement further provides for a limit on the issuance of letters of credit to a maximum of $100.0 million. The Credit Agreement contains customary affirmative and negative covenants for secured credit facilities of this type, including covenants that will limit the ability of the Company and its subsidiaries to, among other things, incur debt, grant liens, make certain acquisitions, dispose of assets, effect a change of control of the Company, make certain restricted payments including certain dividends and stock redemptions, make certain investments or loans, enter into certain transactions with affiliates and certain prohibited uses of proceeds. The Credit Agreement also requires compliance with a minimum fixed-charge coverage ratio if Availability drops below 10% of the Revolver Commitments (as such terms are defined in the Credit Agreement) until the date when no event of default has existed and Availability has been over 10% for 30 consecutive days. The Company paid closing and arrangement fees of $1.1 million on this facility which are included in other assets in the condensed consolidated balance sheets, and are being amortized to interest expense over the five-year life of the facility. As of June 30, 2017 and December 31, 2016, there was $0.1 million outstanding under the Company’s credit facilities, classified as short-term borrowings in the Company’s condensed consolidated balance sheets. The remaining balance in short-term borrowings, as of June 30, 2017, is related to the Company’s international operations.

On April 30, 2010, HF Logistics-SKX, LLC (the “JV”), through its subsidiary HF-T1, entered into a construction loan agreement with Bank of America, N.A., as administrative agent and as a lender, and Raymond James Bank, FSB, as a lender (collectively, the "Construction Loan Agreement"), pursuant to which the JV obtained a loan of up to $55.0 million used for construction of the project on certain property (the "Original Loan"). On November 16, 2012, HF-T1 executed a modification to the Construction Loan Agreement (the "Modification"), which added OneWest Bank, FSB as a lender, and increased the borrowings under the Original Loan to $80.0 million and extended the maturity date of the Original Loan to October 30, 2015. On August 11, 2015, the JV, through HF-T1, entered into an amended and restated loan agreement with Bank of America, N.A., as administrative agent and as a lender, and CIT Bank, N.A. (formerly known as OneWest Bank, FSB) and Raymond James Bank, N.A., as lenders (collectively, the "Amended Loan Agreement"), which amends and restates in its entirety the Construction Loan Agreement and the Modification.

As of the date of the Amended Loan Agreement, the outstanding principal balance of the Original Loan was $77.3 million. In connection with this refinancing of the Original Loan, the JV, the Company and its joint-venture partner HF Logistics (“HF”) agreed that the Company would make an additional capital contribution of $38.7 million to the JV, through HF-T1, to make a prepayment on the Original Loan based on the Company’s 50% equity interest in the JV. The prepayment equaled the Company’s 50% share of the outstanding principal balance of the Original Loan. Under the Amended Loan Agreement, the parties agreed that the lenders would loan $70.0 million to HF-T1 (the "New Loan"). The New Loan was used by the JV, through HF-T1, to (i) refinance all amounts owed on the Original Loan after taking into account the prepayment described above, (ii) pay $0.9 million in accrued interest, loan fees and other closing costs associated with the New Loan and (iii) make a distribution of $31.3 million less the amounts described in clause (ii) to HF. Pursuant to the Amended Loan Agreement, the interest rate on the New Loan is the LIBOR Daily Floating Rate (as defined in the Amended Loan Agreement) plus a margin of 2%. The maturity date of the New Loan is August 12, 2020, which HF-T1 has one option to extend by an additional 24 months, or until August 12, 2022, upon payment of a fee and satisfaction of certain customary conditions. On August 11, 2015, HF-T1 and Bank of America, N.A. entered into an ISDA Master Agreement (together with the schedule related thereto, the "Swap Agreement") to govern derivative and/or hedging transactions that HF-T1 concurrently entered into with Bank of America, N.A. Pursuant to the Swap Agreement, on August 14, 2015, HF-T1 entered into a confirmation of swap transactions (the "Interest Rate Swap") with Bank of America, N.A. The Interest Rate Swap has an effective date of August 12, 2015 and a maturity date of August 12, 2022, subject to early termination at the option of HF-T1, commencing on August 1, 2020. The Interest Rate Swap fixes the effective interest rate of the New Loan at 4.08% per annum. Pursuant to the terms of the JV, HF is responsible for the related interest expense payments on the New Loan, and any amounts related to the Swap Agreement. The full amount of interest expense paid related to the New Loan has been included in the Company’s consolidated statement of equity within non-controlling interests. The Amended Loan Agreement and the Swap Agreement are subject to customary covenants and events of default. Bank of America, N.A. also acts as a lender and syndication agent under the Credit Agreement dated June 30, 2015.

(3) STOCKHOLDERS' EQUITY

During the three and six months ended June 30, 2017, no shares of Class B common stock were converted into shares of Class A common stock. During the three and six months ended June 30, 2016, 682,408 and 1,733,270 shares of Class B common stock were converted into shares of Class A common stock, respectively.

The following table reconciles equity attributable to non-controlling interests (in thousands):

	Six Months Ended June 30,	
	2017	2016
Non-controlling interests, beginning of period	$81,881	$48,178
Net earnings	26,505	21,929
Foreign currency translation adjustment	2,482	(603)
Capital contributions	46	2,905
Capital distributions	(6,753)	(5,199)
Non-controlling interests, end of period	$104,161	$67,210

(4) NON-CONTROLLING INTERESTS

The Company has equity interests in several joint ventures that were established either to exclusively distribute the Company's products primarily throughout Asia or to construct the Company's domestic distribution facility. These joint ventures are variable interest entities ("VIEs") under ASC 810-10-15-14. The Company's determination of the primary beneficiary of a VIE considers all relationships between the Company and the VIE, including management agreements, governance documents and other contractual arrangements. The Company has determined for its VIEs that the Company is the primary beneficiary because it has both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the entity's economic performance, and (b) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Accordingly, the Company includes the assets and liabilities and results of operations of these entities in its condensed consolidated financial statements, even though the Company may not hold a majority equity interest. There have been no changes during 2017 in the accounting treatment or characterization of any previously identified VIE. The Company continues to reassess these relationships quarterly. The assets of these joint ventures are restricted in that they are not available for general business use outside the context of such joint ventures. The holders of the liabilities of each joint venture have no recourse to the Company. The Company does not have a variable interest in any unconsolidated VIEs.

The following VIEs are consolidated into the Company's condensed consolidated financial statements and the carrying amounts and classification of assets and liabilities were as follows (in thousands):

HF Logistics-SKX, LLC	June 30, 2017	December 31, 2016
Current assets	$2,073	$2,006
Non-current assets	106,037	108,668
Total assets	$108,110	$110,674
Current liabilities	$2,606	$2,469
Non-current liabilities	67,270	68,168
Total liabilities	$69,876	$70,637

Distribution joint ventures [1]	June 30, 2017	December 31, 2016
Current assets	$307,395	$289,227
Non-current assets	78,317	49,229
Total assets	$385,712	$338,456
Current liabilities	$131,946	$132,518
Non-current liabilities	4,305	2,214
Total liabilities	$136,251	$134,732

[1] Distribution joint ventures include Skechers Footwear Ltd. (Israel), Skechers China Limited, Skechers Korea Limited, Skechers Southeast Asia Limited, Skechers (Thailand) Limited, Skechers Retail India Private Limited, and Skechers South Asia Private Limited.

The following is a summary of net earnings attributable to, distributions to and contributions from non-controlling interests (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net earnings attributable to non-controlling interests	$13,865	$9,902	$26,505	$21,929
Distributions to:				
HF Logistics-SKX, LLC	1,151	1,210	2,043	2,116
Skechers China Limited	4,710	—	4,710	3,083
Contributions from:				
India distribution joint ventures	—	—	—	2,905
Skechers Footwear Ltd. (Israel)	—	—	46	—

(5) EARNINGS PER SHARE

Basic earnings per share represent net earnings divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share, in addition to the weighted average determined for basic earnings per share, includes potential dilutive common shares using the treasury stock method.

The Company has two classes of issued and outstanding common stock: Class A Common Stock and Class B Common Stock. Holders of Class A Common Stock and holders of Class B Common Stock have substantially identical rights, including rights with respect to any declared dividends or distributions of cash or property and the right to receive proceeds on liquidation or dissolution of the Company after payment of the Company's indebtedness. The two classes have different voting rights, with holders of Class A Common Stock entitled to one vote per share while holders of Class B Common Stock are entitled to ten votes per share on all matters submitted to a vote of stockholders. The Company uses the two-class method for calculating net earnings per share. Basic and diluted net earnings per share of Class A Common Stock and Class B Common Stock are identical. The shares of Class B Common Stock are convertible at any time at the option of the holder into shares of Class A Common Stock on a share-for-share basis. In addition, shares of Class B Common Stock will be automatically converted into a like number of shares of Class A Common Stock upon transfer to any person or entity who is not a permitted transferee.

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

Basic earnings per share	Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Net earnings attributable to Skechers U.S.A., Inc.	$59,535	$74,107	$153,530	$171,719
Weighted average common shares outstanding	155,579	154,049	155,340	153,901
Basic earnings per share attributable to Skechers U.S.A., Inc.	$0.38	$0.48	$0.99	$1.12

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

Diluted earnings per share	Three Months Ended June 30, 2017	2016	Six Months Ended June 30, 2017	2016
Net earnings attributable to Skechers U.S.A., Inc.	$59,535	$74,107	$153,530	$171,719
Weighted average common shares outstanding	155,579	154,049	155,340	153,901
Dilutive effect of nonvested shares	595	974	676	1,011
Weighted average common shares outstanding	156,174	155,023	156,016	154,912
Diluted earnings per share attributable to Skechers U.S.A., Inc.	$0.38	$0.48	$0.98	$1.11

(6) STOCK COMPENSATION

(a) Incentive Award Plan

On April 16, 2007, the Company's Board of Directors adopted the 2007 Incentive Award Plan (the "2007 Plan"), which became effective upon approval by the Company's stockholders on May 24, 2007 and expired pursuant to its terms on May 24, 2017.

On April 17, 2017, the Company's Board of Directors adopted the 2017 Incentive Award Plan (the "2017 Plan"), which became effective upon approval by the Company's stockholders on May 23, 2017. The 2017 Plan replaced and superseded in its entirety the 2007 Plan. A total of 10,000,000 shares of Class A Common Stock are reserved for issuance under the 2017 Plan, which provides for grants of ISOs, non-qualified stock options, restricted stock and various other types of equity awards as described in the plan to the employees, consultants and directors of the Company and its subsidiaries. The 2017 Plan is administered by the Company's Board of Directors with respect to awards to non-employee directors and by the Company's Compensation Committee with respect to other eligible participants.

For stock-based awards, the Company recognized compensation expense based on the grant date fair value. Share-based compensation expense was $7.6 million and $6.2 million for the three months ended June 30, 2017 and 2016, respectively. Share-based compensation expense was $14.2 million and $10.9 million for the six months ended June 30, 2017 and 2016, respectively.

A summary of the status and changes of the Company’s nonvested shares related to the 2007 Plan and the 2017 Plan, as of and for the six months ended June 30, 2017 is presented below:

	Shares	Weighted Average Grant-Date Fair Value
Nonvested at December 31, 2016	3,043,164	$ 24.57
Granted	391,600	22.90
Vested	(729,875)	21.95
Cancelled	(78,000)	32.62
Nonvested at June 30, 2017	2,626,889	24.81

As of June 30, 2017, there was $50.1 million of unrecognized compensation cost related to nonvested common shares. The cost is expected to be amortized over a weighted average period of 2.2 years.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). The updated guidance changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. As of January 1, 2017, the calculation of diluted weighted average shares outstanding was changed prospectively to no longer include excess tax benefits as assumed proceeds. This change did not have a material impact on the Company's calculation of diluted earnings per share. Additionally, this ASU requires the recognition of excess tax benefits and deficiencies as income tax benefits or expenses in the income statement rather than to additional paid-in capital, which has been applied on a prospective basis to settlements of share-based payment awards occurring on or after January 1, 2017. The Company adopted ASU 2016-09 effective January 1, 2017. The Company recorded a $0.3 million expense and a $0.9 million tax benefit in the condensed consolidated statement of earnings for the three and six months ended June 30, 2017, respectively. ASU 2016-09 also requires that excess tax benefits be presented as operating activities on the statement of cash flows, which the Company has elected to apply on a prospective basis.

(b) Stock Purchase Plan

On April 17, 2017, the Company's Board of Directors adopted the 2018 Employee Stock Purchase Plan (the "2018 ESPP"), which the Company's stockholders approved on May 23, 2017. The 2018 ESPP will replace the Company's current employee stock purchase plan, the Skechers U.S.A., Inc. 2008 Employee Stock Purchase Plan (the "2008 ESPP"), which will expire pursuant to its terms on January 1, 2018. The 2018 Employee Stock Purchase Plan provides eligible employees of the Company and its subsidiaries with the opportunity to purchase shares of the Company's Class A Common Stock at a purchase price equal to 85% of the Class A Common Stock's fair market value on the first trading day or last trading day of each purchase period, whichever is lower. The 2018 ESPP generally provides for two six-month purchase periods every twelve months: June 1 through November 30 and December 1 through May 31, except that the initial purchase period under the 2018 ESPP will have a duration of five months, commencing on January 1, 2018 and ending on May 31, 2018. Eligible employees participating in the 2018 ESPP for a purchase period will be able to invest up to 15% of their compensation through payroll deductions during each purchase period. A total of 5,000,000 shares of Class A Common Stock will be available for sale under the 2018 ESPP.

(7) INCOME TAXES

Income tax expense and the effective tax rate for the three and six months ended June 30, 2017 and 2016 were as follows (in thousands, except the effective tax rate):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Income tax expense	$14,109	$12,200	$31,516	$42,768
Effective tax rate	16.1 %	12.7 %	14.9 %	18.1 %

The tax provisions for the three and six months ended June 30, 2017 and 2016 were computed using the estimated effective tax rates applicable to each of the domestic and international taxable jurisdictions for the full year. The Company estimates its ongoing effective annual tax rate for the remainder of 2017 to be between 14% and 19%, which is subject to management's quarterly review and revision, as necessary.

The Company's provision for income tax expense and effective income tax rate are significantly impacted by the mix of the Company's domestic and foreign earnings (loss) before income taxes. In the foreign jurisdictions in which the Company has operations, the applicable statutory rates range from 0% to 34%, which is generally significantly lower than the U.S. federal and state combined statutory rate of approximately 39%. For the three months ended June 30, 2017 and 2016, the increase in rate was due to an increase in the amount of projected domestic earnings relative to the projected foreign earnings. For the six months ended June 30, 2017 and 2016, the decrease in the effective tax rate was primarily due to an increase in the amount of projected foreign earnings relative to projected domestic earnings as compared to the same period in the previous year. In addition, the Company recorded a $0.3 million expense and a $0.9 million tax benefit due to implementing ASU 2016-09 during the three and six months ended June 30, 2017, respectively.

As of June 30, 2017, the Company had approximately $751.6 million in cash and cash equivalents, of which $453.9 million, or 60.4%, was held outside the U.S. Of the $453.9 million held by the Company's foreign subsidiaries, approximately $40.9 million is available for repatriation to the U.S. without incurring further U.S. income taxes and applicable foreign income and withholding taxes in excess of the amounts accrued in the Company's condensed consolidated financial statements. Under current applicable tax laws, if the Company chooses to repatriate some or all of the funds designated as indefinitely reinvested outside the U.S., the amount repatriated would be subject to U.S. income taxes and applicable foreign income and withholding taxes. The Company does not expect to repatriate any of the funds presently designated as indefinitely reinvested outside the U.S. As such, the Company did not provide for deferred income taxes on its accumulated undistributed earnings of the Company's foreign subsidiaries.

(8) BUSINESS AND CREDIT CONCENTRATIONS

The Company generates sales in the United States; however, several of its products are sold into various foreign countries, which subjects the Company to the risks of doing business abroad. In addition, the Company operates in the footwear industry, and its business depends on the general economic environment and levels of consumer spending. Changes in the marketplace may significantly affect management's estimates and the Company's performance. Management performs regular evaluations concerning the ability of customers to satisfy their obligations and provides for estimated doubtful accounts. Domestic accounts receivable, which generally do not require collateral from customers, were $271.5 million and $169.4 million before allowances for bad debts, sales returns and chargebacks at June 30, 2017 and December 31, 2016, respectively. Foreign accounts receivable, which in some cases are collateralized by letters of credit, were $272.3 million and $199.1 million before allowance for bad debts, sales returns and chargebacks at June 30, 2017 and December 31, 2016, respectively. The Company's credit losses attributable to write-offs for the three months ended June 30, 2017 and 2016 were $2.1 million and $1.5 million, respectively. The Company's credit losses attributable to write-offs for the six months ended June 30, 2017 and 2016 were $4.6 million and $4.0 million, respectively.

Assets located outside the U.S. consist primarily of cash, accounts receivable, inventory, property, plant and equipment, and other assets. Net assets held outside the United States were $1.235 billion and $1.060 billion at June 30, 2017 and December 31, 2016, respectively.

The Company's net sales to its five largest customers accounted for approximately 14.0% and 11.8% of total net sales for the three months ended June 30, 2017 and 2016, respectively. The Company's net sales to its five largest customers accounted for approximately 13.4% and 12.7% of total net sales for the six months ended June 30, 2017 and 2016, respectively. No customer accounted for more than 10.0% of the Company's net sales during the three and six months ended June 30, 2017 and 2016. No customer accounted for more than 10.0% of trade receivables at June 30, 2017 or December 31, 2016.

The Company's top five manufacturers produced the following, as a percentage of total production, for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Manufacturer #1	20.0%	25.1%	21.1%	25.6%
Manufacturer #2	11.0%	10.4%	11.0%	10.7%
Manufacturer #3	8.1 %	8.9 %	8.6 %	9.6 %

Manufacturer #4	6.3 %	6.6 %	6.0 %	5.4 %
Manufacturer #5	6.2 %	5.0 %	5.0 %	4.2 %
	51.6%	56.0%	51.7%	55.5%

The majority of the Company's products are produced in China and Vietnam. The Company's operations are subject to the customary risks of doing business abroad, including, but not limited to, currency fluctuations and revaluations, custom duties and related fees, various import controls and other monetary barriers, restrictions on the transfer of funds, labor unrest and strikes, and, in certain parts of the world, political instability. The Company believes it has acted to reduce these risks by diversifying manufacturing among various factories. To date, these business risks have not had a material adverse impact on the Company's operations.

(9) SEGMENT AND GEOGRAPHIC REPORTING

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net sales:				
Domestic wholesale	$341,105	$320,498	$699,537	$680,768
International wholesale	358,059	303,432	848,511	723,467
Retail	326,770	253,880	550,694	452,369
Total	$1,025,934	$877,810	$2,098,742	$1,856,604

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Gross profit:				
Domestic wholesale	$126,000	$124,656	$265,808	$265,171
International wholesale	165,324	139,288	375,638	315,308
Retail	196,997	152,310	323,373	267,927
Total	$488,321	$416,254	$964,819	$848,406

	June 30, 2017	December 31, 2016
Identifiable assets:		
Domestic wholesale	$1,177,172	$1,161,719
International wholesale	1,106,639	954,874
Retail	325,479	277,077
Total	$2,609,290	$2,393,670

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Additions to property, plant and equipment:				
Domestic wholesale	$1,749	$1,096	$3,282	$11,232
International wholesale	19,629	5,695	31,422	21,674
Retail	26,242	13,045	41,798	22,128
Total	$47,620	$19,836	$76,502	$55,034

Geographic Information:

The following summarizes the Company’s operations in different geographic areas for the periods indicated (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net Sales [1]:				
United States	$558,047	$509,902	$1,080,843	$1,022,139
Canada	38,154	34,433	86,382	71,501
Other international [2]	429,733	333,475	931,517	762,964
Total	$1,025,934	$877,810	$2,098,742	$1,856,604

	June 30, 2017	December 31, 2016
Property, plant and equipment, net:		
United States	$378,495	$374,459
Canada	10,819	10,410
Other international [(2)]	138,127	109,604
Total	$527,441	$494,473

(1) The Company has subsidiaries in Asia, Central America, Europe, the Middle East, North America, and South America that generate net sales within those respective regions and in some cases the neighboring regions. The Company has joint ventures in Asia that generate net sales from those regions. The Company also has a subsidiary in Switzerland that generates net sales from that country in addition to net sales to distributors located in numerous non-European countries. External net sales are attributable to geographic regions based on the location of each of the Company's subsidiaries. A subsidiary may earn revenue from external net sales and external royalties, or from inter-subsidiary net sales, royalties, fees and commissions provided in accordance with certain inter-subsidiary agreements. The resulting earnings of each subsidiary in its respective country are recognized under each respective country's tax code. Inter-subsidiary revenues and expenses subsequently are eliminated in the Company's condensed consolidated financial statements and are not included as part of the external net sales reported in different geographic areas.

(2) Other international includes Asia, Central America, Europe, the Middle East, North America (excluding U.S.) and South America.

In response to the State Department's trade restrictions with Sudan and Syria, we do not authorize or permit any distribution or sales of our product in these countries, and we are not aware of any current or past distribution or sales of our product in Sudan or Syria.

(10) RELATED PARTY TRANSACTIONS

On July 29, 2010, the Company formed the Skechers Foundation (the "Foundation"), which is a 501(c)(3) non-profit entity that does not have any shareholders or members. The Foundation is not a subsidiary of, and is not otherwise affiliated with the Company, and the Company does not have a financial interest in the Foundation. However, two officers and directors of the Company, Michael Greenberg, the Company's President, and David Weinberg, the Company's Chief Operating Officer and Chief Financial Officer, are also officers and directors of the Foundation. During the three months ended June 30, 2017 and 2016, the Company made contributions to the Foundation of $250,000 in each period. During the six months ended June 30, 2017 and 2016, the Company made contributions of $500,000 to the Foundation in each period.

(11) LITIGATION

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

Personal Injury Lawsuits Involving Shape-ups — As previously reported, on February 20, 2011, Skechers U.S.A., Inc., Skechers U.S.A., Inc. II and Skechers Fitness Group were named as defendants in a lawsuit that alleged, among other things, that Shape-ups are defective and unreasonably dangerous, negligently designed and/or manufactured, and do not conform to representations made by the Company, and that the Company failed to provide adequate warnings of alleged risks associated with Shape-ups. In total, the Company is named as a defendant in 50 currently pending cases (some on behalf of multiple plaintiffs) filed in various courts that assert further varying injuries but employ similar legal theories and assert similar claims to the first case, as well as claims for breach of express and implied warranties, loss of consortium, and fraud. Although there are some variations in the relief sought, the plaintiffs generally seek compensatory and/or economic damages, exemplary and/or punitive damages, and attorneys' fees and costs.

On December 19, 2011, the Judicial Panel on Multidistrict Litigation issued an order establishing a multidistrict litigation ("MDL") proceeding in the United States District Court for the Western District of Kentucky entitled In re Skechers Toning Shoe Products Liability Litigation, case no. 11-md-02308-TBR. Since 2011, a total of 1,235 personal injury cases have been filed in or transferred to the MDL proceeding. The Company has resolved 1,743 personal injury claims in the MDL proceedings, comprised of 1,141 that were filed as formal actions and 602 that were submitted by plaintiff fact sheets. The Company has also settled 37 claims in principle—20 filed cases and 17 claims submitted by plaintiff fact sheets—either directly or pursuant to a global settlement program that has been approved by the claimants' attorneys (described in greater detail below). Further, 70 cases in the MDL proceeding have been dismissed either voluntarily or on motions by the Company and 38 unfiled claims submitted by plaintiff fact sheet have been abandoned. Between the consummated settlements and cases subject to the settlement program, all but 4 personal injury cases pending in the MDL have been or are expected to be resolved. On August 6, 2015, the Court entered an order staying all deadlines, including trial, pending further order of the Court. On March 30 and 31, 2017, the Court entered orders permitting limited fact discovery in two cases. No trial dates have been set. All other MDL actions remain stayed.

Skechers U.S.A., Inc., Skechers U.S.A., Inc. II and Skechers Fitness Group also have been named as defendants in a total of 72 personal injury actions filed in various Superior Courts of the State of California that were brought on behalf of 920 individual plaintiffs (360 of whom also submitted MDL court-approved questionnaires for mediation purposes in the MDL proceeding). Of those cases, 68 were originally filed in the Superior Court for the County of Los Angeles (the “LASC cases”). On August 20, 2014, the Judicial Council of California granted a petition by the Company to coordinate all personal injury actions filed in California that relate to Shape-ups with the LASC cases (collectively, the “LASC Coordinated Cases”). On October 6, 2014, three cases that had been pending in other counties were transferred to and coordinated with the LASC Coordinated Cases. On April 17, 2015, an additional case was transferred to and coordinated with the LASC Coordinated Cases. Fifty-three actions brought on behalf of a total of 638 plaintiffs have been settled and fully dismissed. Twelve actions have been partially dismissed, with the claims of 226 plaintiffs in those actions having been fully resolved and dismissed. The claims of other two plaintiffs from these multi-plaintiff lawsuits have been settled in principle pursuant to a global settlement program that has been approved by the plaintiffs’ attorneys (described in greater detail below). An additional single plaintiff action has been settled in principle and should be dismissed in the short term. One single-plaintiff lawsuit and the claims of 28 additional plaintiffs in multi-plaintiff lawsuits have been dismissed entirely, either voluntarily or on motion by the Company. The claims of 21 additional persons have been dismissed in part, either voluntarily or on motions by the Company. Thus, taking into account both consummated settlements and cases subject to the settlement program, only 14 lawsuits on behalf of a total of 24 plaintiffs are expected to remain in the LASC Coordinated Cases. Discovery is continuing in those fourteen remaining cases. No trial dates have been set.

In other state courts, a total of 12 personal injury actions (some on behalf of numerous plaintiffs) have been filed that have not been removed to federal court and transferred to the MDL. Eleven of those actions have been resolved and dismissed. The last remaining action in a state court other than California was filed in Missouri on January 4, 2016 on behalf of a single plaintiff. The complaint was served on November 14, 2016. We have answered the complaint and denied all material allegations asserted therein. The parties are now engaged in discovery. No trial date has been set.

With respect to the global settlement programs referenced above, the personal injury cases in the MDL and LASC Coordinated Cases and in other state courts were largely solicited and handled by the same plaintiffs law firms. Accordingly, mediations to discuss potential resolution of the various lawsuits brought by these firms were held on May 18, June 18, and July 24, 2015. At the conclusion of those mediations, the parties reached an agreement in principle on a global settlement program that is expected to resolve all or substantially all of the claims by persons represented by those firms. A master settlement agreement was executed as of March 24, 2016 and the parties are in the process of completing individual settlements. To the extent that the settlements with individual claimants are not finalized or otherwise consummated such that the litigation proceeds, it is too early to predict the outcome of any case, whether adverse results in any single case or in the aggregate would have a material adverse impact on our operations or financial position, and whether insurance coverage will be adequate to cover any losses. The settlements have been reached for business purposes in order to end the distraction of litigation, and the Company continues to believe it has meritorious defenses and intends to defend any remaining cases vigorously. In addition, it is too early to predict whether there will be future personal injury cases filed which are not covered by the global settlement program, whether adverse results in any single case or in the aggregate would have a material adverse impact on our operations or financial position, and whether insurance coverage will be available and/or adequate to cover any losses.

Converse, Inc. v. Skechers U.S.A., Inc. — On October 14, 2014, Converse filed an action against the Company in the United States District Court for the Eastern District of New York, Brooklyn Division, Case 1:14-cv-05977-DLI-MDG, alleging trademark infringement, false designation of origin, unfair competition, trademark dilution and deceptive practices arising out of the Company's alleged use of certain design elements on footwear. The complaint seeks, among other things, injunctive relief, profits, actual damages, enhanced damages, punitive damages, costs and attorneys' fees. On October 14, 2014, Converse also filed a complaint naming 27 respondents including the Company with the U.S. International Trade Commission (the "ITC" or "Commission"), Federal Register Doc. 2014-24890, alleging violations of federal law in the importation into and the sale within the United States of certain footwear. Converse has requested that the Commission issue a general exclusion order, or in the alternative a limited exclusion order, and cease and desist orders. On December 8, 2014, the District Court stayed the proceedings before it. On December 19, 2014, the Company responded to the ITC complaint, denying the material allegations and asserting affirmative defenses. A trial before an administrative law judge of the ITC was held in August 2015. On November 15, 2015, the ITC judge issued his interim decision finding that certain discontinued products (Daddy'$ Money and HyDee HyTops) infringed on Converse's intellectual property, but that other, still active product lines (Twinkle Toes and Bobs Utopia) did not. On February 3, 2016, the ITC decided that it would review in part certain matters that were decided by the ITC judge. On June 28, 2016, the full ITC issued a ruling affirming that Skechers Twinkle Toes and Bobs canvas shoes do not infringe Converse's Chuck Taylor Midsole Trademark and affirming that Converse's common law trademark was invalid. The full ITC also invalidated Converse's registered trademark. Converse appealed this decision to the United States Court of Appeals for the Federal Circuit. On January 27, 2017, Converse filed its appellate brief but did not contest the portion of the decision that held that Skechers Twinkle Toes and Bobs canvas shoes do not infringe. On June 26, 2017, we filed our responsive brief, and we are currently awaiting the court's setting of a date for oral argument. While it is too early to predict the outcome of these legal proceedings or whether an adverse result in either or both of them would have a material adverse impact on the Company's operations or financial position, the Company believes it has meritorious defenses and intend to defend these legal matters vigorously.

In accordance with U.S. GAAP, the Company records a liability in its condensed consolidated financial statements for loss contingencies when a loss is known or considered probable and the amount can be reasonably estimated. When determining the estimated loss or range of loss, significant judgment is required to estimate the amount and timing of a loss to be recorded. Estimates of probable losses resulting from litigation and governmental proceedings are inherently difficult to predict, particularly when the matters are in the procedural stages or with unspecified or indeterminate claims for damages, potential penalties, or fines. Accordingly, the Company cannot determine the final amount, if any, of its liability beyond the amount accrued in the condensed consolidated financial statements as of June 30, 2017, nor is it possible to estimate what litigation-related costs will be in the future.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and Notes thereto in Item 1 of this report and our annual report on Form 10-K for the year ended December 31, 2016.

We intend for this discussion to provide the reader with information that will assist in understanding our condensed consolidated financial statements, the changes in certain key items in those financial statements from period to period, and the primary factors that accounted for those changes, as well as how certain accounting principles affect our condensed consolidated financial statements. The discussion also provides information about the financial results of the various segments of our business to provide a better understanding of how those segments and their results affect the financial condition and results of operations of our Company as a whole.

This quarterly report on Form 10-Q may contain forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, which can be identified by the use of forward-looking language such as "intend," "may," "will," "believe," "expect," "anticipate" or other comparable terms. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected in forward-looking statements, and reported results shall not be considered an indication of our future performance. Factors that might cause or contribute to such differences include:

- global economic, political and market conditions including the difficult consumer retail market in the United States and the uncertainty of the European and Asian markets;
- our ability to maintain our brand image and to anticipate, forecast, identify, and respond to changes in fashion trends, consumer demand for the products and other market factors;
- our ability to remain competitive among sellers of footwear for consumers, including in the highly competitive performance footwear market;
- our ability to sustain, manage and forecast our costs and proper inventory levels;
- the loss of any significant customers, decreased demand by industry retailers and the cancellation of order commitments;
- our ability to continue to manufacture and ship our products that are sourced in China and Vietnam, which could be adversely affected by various economic, political or trade conditions, or a natural disaster in China or Vietnam;
- our ability to predict our revenues, which have varied significantly in the past and can be expected to fluctuate in the future due to a number of reasons, many of which are beyond our control;
- sales levels during the spring, back-to-school and holiday selling seasons; and
- other factors referenced or incorporated by reference in our annual report on Form 10-K for the year ended December 31, 2016 under the captions "Item 1A: Risk Factors" and "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations."

The risks included here are not exhaustive. Other sections of this report may include additional factors that could adversely impact our business, financial condition and results of operations. 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, which reflect our opinions only as of the date of this quarterly report, as a prediction of actual results. We undertake no obligation to publicly release any revisions to the forward-looking statements after the date of this document, except as otherwise required by reporting requirements of applicable federal and states securities laws.

FINANCIAL OVERVIEW

Our net sales for the three months ended June 30, 2017 were $1.026 billion, an increase of $148.1 million, or 16.9%, as compared to net sales of $877.8 million for the three months ended June 30, 2016, which was primarily attributable to increased sales across all our business segments. Gross margins increased slightly to 47.6% for the three months ended June 30, 2017 from 47.4% for the same period in the prior year. Net earnings attributable to Skechers U.S.A., Inc. were $59.5 million for the three months ended June 30, 2017, a decrease of $14.6 million, or 19.7%, compared to net earnings of $74.1 million in the prior-year period. Diluted net earnings per share attributable to Skechers U.S.A., Inc. for the three months ended June 30, 2017 were $0.38, which reflected a 20.8% decrease from the $0.48 diluted earnings per share reported in the same prior-year period. The decrease in net earnings and diluted net earnings per share attributable to Skechers U.S.A., Inc. for the three months ended June 30, 2017 was due to increased selling expenses of $24.0 million, increased general and administrative expenses of $62.1 million, of which $22.3 million was used to open and operate 68 new domestic and international retail stores and $16.9 million was to support our growth in China, which was partially offset by $72.0 million in increased gross profit primarily due to increased net sales. The results of operations for the three months ended June 30, 2017 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2017.

We have three reportable segments – domestic wholesale sales, international wholesale sales, and retail sales, which includes e-commerce sales. We evaluate segment performance based primarily on net sales and gross margins.

Revenue by segment as a percentage of net sales was as follows:

	Three Months Ended June 30, 2017	2016
Percentage of revenues by segment:		
Domestic wholesale	33.2 %	36.5 %
International wholesale	34.9 %	34.6 %
Retail	31.9 %	28.9 %
Total	100.0%	100.0%

As of June 30, 2017, we owned and operated 614 stores, which included 435 domestic retail stores and 179 international retail stores. We have established our presence in what we believe to be most of the major domestic retail markets. During the first six months of 2017, we opened five domestic concept stores, four domestic outlet stores, 14 domestic warehouse stores, nine international concept stores, nine international outlet stores, and four international warehouse stores. In addition, we closed one domestic concept store. We review all of our stores for impairment annually, or more frequently if events occur that may be an indicator of impairment, and we carefully review our under-performing stores and consider the potential for non-renewal of leases upon completion of the current term of the applicable lease.

During the remainder of 2017, we intend to focus on: (i) continuing to develop new lifestyle and performance product at affordable prices to increase product count for all customers, (ii) continuing to manage our inventory and expenses to be in line with expected sales levels, (iii) growing our international business, and (iv) strategically expanding our retail distribution channel by opening another 35 to 40 Company-owned retail stores during the remainder of the year.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, selected information from our results of operations (in thousands) and as a percentage of net sales:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017		2016		2017		2016	
Net sales	$1,025,934	100.0 %	$877,810	100.0 %	$2,098,742	100.0 %	$1,856,604	100.0 %
Cost of sales	537,613	52.4	461,556	52.6	1,133,923	54.0	1,008,198	54.3
Gross profit	488,321	47.6	416,254	47.4	964,819	46.0	848,406	45.7
Royalty income	3,221	0.3	3,307	0.4	7,451	0.3	5,932	0.3
	491,542	47.9	419,561	47.8	972,270	46.3	854,338	46.0
Operating expenses:								
Selling	99,950	9.7	75,966	8.7	173,759	8.3	129,844	7.0
General and administrative	305,283	29.8	243,240	27.7	587,779	28.0	485,589	26.1
	405,233	39.5	319,206	36.4	761,538	36.3	615,433	33.1
Earnings from operations	86,309	8.4	100,355	11.4	210,732	10.0	238,905	12.9
Interest income	381	—	319	—	794	—	585	—
Interest expense	(1,845)	(0.2)	(1,861)	(0.2)	(3,334)	(0.1)	(3,249)	(0.2)
Other, net	2,664	0.3	(2,604)	(0.2)	3,359	0.2	175	—
Earnings before income tax expense	87,509	8.5	96,209	11.0	211,551	10.1	236,416	12.7
Income tax expense	14,109	1.3	12,200	1.4	31,516	1.5	42,768	2.3
Net earnings	73,400	7.2	84,009	9.6	180,035	8.6	193,648	10.4
Less: Net earnings attributable to non-controlling interests	13,865	1.4	9,902	1.2	26,505	1.3	21,929	1.2
Net earnings attributable to Skechers U.S.A., Inc.	$59,535							