

SKECHERS USA INC
Form 10-K
March 16, 2006

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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, 2005

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 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 the Form 10-K or any amendment to this Form 10-K.

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

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(Check one): Large accelerated filer Accelerated filer Non-accelerated filer

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, 2005, 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 \$324 million based upon the closing price of \$14.26 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 March 1, 2006: 23,879,447.

The number of shares of Class B Common Stock outstanding as of March 1, 2006: 16,445,889.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement issued in connection with the 2006 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 within the meaning of the Private Securities Litigation Reform Act of 1995, including statements with regards to future revenue, projected 2006 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, and may contain the words likely, believe, anticipate, expect, estimate, intend, plan, project, will continue, will result, could, may, might, or any variations of such words with similar meanings. Any such statements are subject to risks and uncertainties that could cause our company's 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, the occurrence of a natural disaster or outbreak of a pandemic disease in China, or electrical shortages, labor shortages or work stoppages that may lead to production delays; 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 due to energy shortages or natural disasters such as an earthquake due to the location of our domestic warehouse, headquarters and a substantial number of our retail stores in California; changes in business strategy or development plans; the ability to obtain additional capital to fund operations, finance growth and service debt obligations; the ability to attract and retain qualified personnel; compliance with the financial covenants in our long-term debt agreements and \$150 million line of credit facility; compliance with recent corporate governance legislation including the Sarbanes-Oxley Act of 2002; 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 filed with the United States Securities and Exchange Commission (the "SEC").

The risks included here are not exhaustive. Other sections of this annual 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. 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. 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.

GENERAL

We design and market Skechers-branded contemporary footwear for men, women and children under seven individual brand names. 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 seven 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 34 concept stores, 56 factory outlet stores and 32 warehouse outlet stores in the United States, and 10 concept stores and two warehouse 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. For Skechers in 2005, we capitalized on the popularity of American Idol winner and rising star Carrie Underwood in our domestic and international print advertising, and launched television sponsor spots for many of our Skechers branded lines as well as some of our uniquely branded lines. For Mark Nason, Michelle K and 310 Motoring, we also developed print ads, including ads featuring multi-platinum hip hop recording artist The Game for his signature 310 footwear line. Our Marc Ecko Footwear is supported through print ads developed by Marc Ecko for the apparel lines Ecko Unltd. and Ecko Red. Our strategy continues to focus on print advertisements in targeted publications such as *GQ*, *Lucky*, *Details*, *Seventeen*, *Maxim*, *People*, *Teen People*, *Teen Vogue*, *Slam*, *In Style*, and many others.

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. Each of our seven Skechers-branded product lines benefits from the Skechers reputation for contemporary and progressive styling, quality, comfort and affordability. We have seven product lines currently in the marketplace that are not branded with the Skechers name that 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 BRANDS

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

For men, the Casuals category includes black and brown boots and shoes that generally have a rugged urban design some with industrial-inspired fashion features. This category is defined by the heavy-lugged outsole and value-oriented materials employed in the uppers as well as leather

uppers. For women, the Casuals category includes basic black and brown oxfords

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and slip-ons, lug outsole boots, and casual sandals. The women's line also uses value-oriented materials, but a growing number of styles may also be designed in leather. We design and price both the men's and women's categories to appeal primarily to young persons 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 still utilize the heavy-lugged outsole and value-oriented materials. This category is designed and priced for young men seeking their first work or evening shoe. For women, the Dress Casual line is comprised of more stylized boots and shoes, which may include leather uppers, shearling or faux fur lining or trim, or which in general may be more trend-influenced.

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. 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. We market and package the Outdoor styles in a shoe box that is distinct from that of other categories in the Skechers USA line of footwear.

Our Sport Fusion line is comprised of low-profile, sport-influenced Euro casuals targeted at trend-conscious young men and women. With many outsoles adopted from our men's Sport and women's Active lines, this line primarily features leather or nubuck uppers, but may also include mesh.

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 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 ethyl vinyl acetate (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. 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-zag straps and cross straps, among others. The line also now includes Mary Jane, sandal and open back styles. Active sneakers are typically retailed through specialty casual shoe stores and department stores.

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Somethin Else from Skechers. Targeting 12- to 25-year-old trend-savvy females, the Somethin Else from Skechers line is focused on current fashions through an array of stylish shoes, boots, heels and sandals. With a growing offering that includes flats, heeled boots, clogs and sport-influenced looks, the line is designed to meet junior consumers needs from school to work to weekends and is a complementary line for women who already wear Skechers USA, Skechers Active and Skechers Sport. Many styles are made from more affordable materials such as man-made leather, offering more young consumers the opportunity to buy trend-right shoes at a reasonable price. This line is typically sold through department and specialty stores.

Collection by Skechers. The Collection by Skechers line is comprised of stylish dress shoes, dress casual shoes and sandals for the young fashion-forward male consumer. The looks include classic tailored and fashion-forward square, round and pointed lasts in a variety of styles, such as bicycle toes, monk straps, wingtips, oxfords, cap toes, demi-boots and boots. The outsoles project a sleeker profile and may be either leather or man-made. The uppers are quality leathers including glossy, box, distressed and aniline. Collection by Skechers 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 sport oxfords, field boots, trail hikers and athletic shoes. The Skechers Work line includes the (i) Lightweight Aluminum Series (LAS), (ii) Steel Toe, (iii) Occupational and (iv) Slip-Resistant categories, which may feature electrical hazard, electrostatic-dissipative and slip-resistant technologies, as well as breathable, seam-sealed Hydroguard™ waterproof membranes. Our LAS, Steel Toe and Occupational products have been independently tested and certified to meet ASTM F 2412/2413-05; CSA Z195-02 or SATRA PM 77 standards, and our slip-resistant soles have been tested pursuant to the James testing method for slip resistance. The uppers are in high-quality leather, nubuck, truebuck and durabuck. Constructed on high-abrasion, long wearing soles, the line is designed for men and women with jobs that require certain safety requirements. Skechers Work is primarily marketed through business-to-business channels, but is also available direct-to-consumers and through select department and specialty stores.

Our LAS trail hikers and sport oxfords are exclusively designed for industry professionals who need lightweight, all-day footwear protection. Their innovative design includes a durable, ultra-lightweight safety toe, torque flex construction and high-grade materials for superior strength and comfort.

Our Steel Toe athletic sneakers, boots, hikers, oxfords and sport oxfords, which are ideal for environments requiring safety footwear. These durable styles feature breathable lining, oil and abrasion resistant outsoles and steel toe design for optimal protection, all-day comfort and prolonged durability.

Our Occupational boots, oxfords and hikers offer versatile features for those requiring utility, safety and comfort features, but who also want style. Designed with an array of textured uppers and colorways, the footwear capitalizes on function and comfort from breathable lining to contoured insoles and abrasion-resistant outsoles for prolonged wear.

Our Slip-Resistant boots, athletics, sport and slip-on oxfords, and clogs are ideal for the service industry. These shoes offer comfort and safety in dry or wet conditions by utilizing breathable lining and James-tested slip, oil and abrasion resistant outsoles for optimal safety and reliability.

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 and (iii) Somethin Else from Skechers for Girls, which is trend-inspired boots, shoes, sandals and dress sneakers. Skechers Kids and Somethin Else from Skechers 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. 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.

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Something Else from Skechers for Girls is a line of trend-right sandals, shoes, boots, street sneakers and dress casuals for young girls. For this line, we have taken many of our successful junior bottoms and tailored them to a younger demographic, lowering platforms and wedges as needed and creating all new upper treatments and colors on select styles. Many styles are made from more affordable materials such as man-made leather, offering young consumers the opportunity to buy stylish shoes at affordable prices.

FASHION AND STREET BRANDS

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

Rhino Red and Unltd. by Marc Ecko. Rhino Red is a line of women's classic and fashion-forward fusion sneakers and casual and dress casual heels and boots. Unltd. by Marc Ecko is a line of men's street-inspired traditional sneakers, fusion sneakers and urban-focused casuals. 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. 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.

310 Motoring. The 310 Motoring footwear collection 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, cutting-edge athletics, heritage to high-design boots and shoes, and sophisticated driving-inspired shoes and boots for men and boys. 310 Motoring footwear is available in select department stores, specialty retailers and urban independents.

In the last week of 2005, we launched multi-platinum hip hop recording artist The Game's signature 310 sneaker, known as Hurricane by 310, in select specialty athletic stores. The initial Hurricane street athletic sneaker consists of one color and one style. Additional colors are planned to launch in the first quarter of 2006.

Michelle K. Targeted toward stylish 18- to 34-year-old women, Michelle K is a signature designer line of fashion forward fusion sneakers, sporty boots and sandals. The Michelle K line is marked by a unique combination of materials, textures and colors. The line is available in select upscale department stores and better boutiques. It is sold internationally under the name Skechers by designer Michelle K. This brand also includes Michelle K Girl, a fashion-forward line, primarily comprised of fusion casual sneakers as well as boots and sandals marked by a unique combination of colors, materials, textures and embellishments.

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, an uninhibited designer boot line for discerning women, was launched in the fourth quarter of 2005 as a response to the reaction of women to the men's Mark Nason collection. The ultimate accompaniment to designer denim and casual couture, 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. Mark Nason and Siren by Mark Nason are available in upscale department stores and better boutiques.

Kitson. Launched in the fourth quarter of 2005, Kitson footwear is a line of fashion sneakers and sandals targeted to hip and trend-savvy women and girls. A licensed brand, Kitson is an ultra-hip Los Angeles boutique known for sparking the hottest and newest trends, and where young Hollywood celebrities come to shop. Kitson goods are must-have merchandise, featured in leading style and lifestyle magazines. Kitson footwear is available at the Kitson retail boutique, upscale department stores and other boutiques.

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

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range of 5- to 40-year-old consumers, with an exclusive selection for infants and toddlers. While many 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 footwear 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 customers for information on current retail selling 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 brand's 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 2005, we had four manufacturers that accounted for approximately 59.7% of total purchases. One manufacturer accounted for 32.4%, and one other accounted for 11.2% of our total purchases during the year ended December 31, 2005. 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 affords 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

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we share this sales information with our wholesale accounts. 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 165-person staff working from our offices in China and Taiwan. We believe that our Asian presence allows us to negotiate supplier and manufacturer arrangements more effectively, decrease 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 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 and Taiwan 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 endorsees 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 projected net sales. In 2005, we advertised in a more efficient manner while net sales increased, which resulted in advertising and marketing expenditures equaling 5.8% of our annual net sales, which was below our historical range of 8% to 10% of annual net sales.

Advertising. The majority of our advertising is conceptualized by our in-house design team. In 2005, we utilized the creative services of an outside photographer to also design several key ads, from which our design team was able to create additional advertisements and marketing materials. This allowed us to take a new approach to our advertising while also maintaining control and integrity of the Skechers brand by building a relationship with one outside creative source yet still crafting ads in-house.

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 other brands to youthful, contemporary lifestyles and attitudes rather than to market a particular footwear product. In addition to our compelling Skechers lifestyle ads, we have also created product specific ads for our men's lines to appeal to both men and women who purchase footwear for men. Our ads are designed with a broad approach to eliminate single categorization and 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. Through the first half of 2005, we continued

our international endorsement agreement with global superstar Christina Aguilera for our women's lines. When the agreement expired at the end of June 2005, we signed 2005 American Idol winner and rising star Carrie Underwood to appear in Skechers advertisements in support of our women's lines. In recent years, we had similar endorsement agreements for Skechers with singer and actress Britney Spears, professional basketball player and actor Rick Fox, and actors Robert Downey, Jr., Matt Dillon and Rob Lowe. We also signed multi-platinum hip hop superstar The Game as well as the Oscar-nominated actor Terrence Howard to support our 310 Motoring brand. From time to

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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 our Michelle K, Mark Nason and 310 Motoring lines through individual unique print advertisements. For Michelle K and Mark Nason, we have focused on key-selling styles in product-driven ads that captured the brands' essence. For 310 Motoring, we have created several lifestyle ads that reflected the high-end roots of this automotive inspired line, including ads featuring multi-platinum hip hop recording artist The Game for his signature 310 footwear line. Unltd. by Marc Ecko and Rhino Red advertisements are created and implemented by Ecko.Complex, LLC dba Ecko Unltd., the parent company of Ecko Unltd. and Ecko Red, which allows for exposure of our Mark Ecko footwear brands without us having to incur significant advertising costs.

With a targeted approach, our print ads appear regularly in popular fashion and lifestyle consumer publications, such as *GQ*, *Cosmopolitan*, *Elle*, *Lucky*, *Seventeen*, *Teen People*, *Maxim*, *Slam*, *Rolling Stone*, and *Complex*, as well as in weekly publications such as *People*, *Us Weekly*, *Star*, and *TV Guide*, among others. Our television commercials are primarily produced in-house and air during key selling seasons. In 2005, we created product-driven sponsor spots for Skechers Sport Fusion for men and women, Skechers Sport for men, Skechers Work, and Skechers for boys and girls, as well as for Michelle K Girl and 310 Motoring. We have found these to be a cost-effective way to advertise during key national and cable programming. Our in-house 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 launched a multi-level outdoor campaign that included 800-plus mall kiosks, billboards, transportation systems and telephone kiosks. We believe these are effective and efficient ways to reach a broad range of consumers and leave a lasting impression of our Skechers branded lines.

Trend-Influenced Marketing/Public Relations. Our public relations team's 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 has been prominently displayed and referenced on news and magazine shows including *The Today Show*, *Good Day L.A.*, *Country Music Television*, and *E! Style*; and on entertainment shows, including *Law & Order*, *Fear Factor*, and *The Dr. Phil Show*, among others. We have also amassed an array of prominent product placements in magazines including *Lucky*, *Seventeen*, *Teen People*, *Teen Vogue*, *CosmoGirl*, *InStyle*, *Stuff*, *Maxim*, *Slam*, *Cargo*, *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, Eva Longoria, Black Eyed Peas, Big & Rich, Sugarland, Drew Barrymore, John Corbett, Halle Berry, Ice-T, 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 and our retail partners' locations. Skechers promotional strategies have encompassed in-store specials, concert promotions, 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 team supports wholesale accounts, distributors and our retail stores by developing displays that effectively leverage our products at the point of purchase. Our point-of-purchase display items include signage, graphics, displays, counter cards, banners and other merchandising items. These materials mirror the look and feel of our national print advertising in order to reinforce brand image at the point-of-purchase.

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 the leading trade shows. Along with specialty trade shows, we exhibit at WSA's The Shoe Show, FFANY and MAGIC in the United States, and GDS, MICAM, Bread & Butter, 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

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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 Michelle K, 310 Motoring and our Marc Ecko footwear lines, we have created individual exhibits to ensure the brand integrity. Our innovative exhibits have won numerous awards over the years, including Best Booth Design at the WSA Shoe Show, February 2001 and February 2003, and for our Unltd. by Marc Ecko and Rhino Red booth in August 2004 and February 2005. For FFANY, we show in our own New York showroom as is common during this show.

Internet. We also promote our brand image through our e-commerce website, www.skechers.com, to consumers who access the Internet. This website currently enables us to present information on our products and store locations to consumers. Our website is interactive, affording consumers the ability to directly order products on the Internet, and it provides us a mechanism for customer feedback as well as allowing us to receive and respond directly to consumer feedback. Our website is intended to enhance the Skechers brand without the associated costs of advertising.

Along with www.skechers.com, we have also established unique Internet websites for Michelle K (www.michellek.com), Mark Nason (www.marknason.com) and 310 Motoring (www.310motoring.com). These websites are designed to serve as marketing tools, properly imaging these brands while also informing customers about the respective product lines.

PRODUCT DISTRIBUTION CHANNELS

We have three reportable segments—domestic wholesale sales, international wholesale sales and retail sales. In addition, we report an All other segment, which includes our e-commerce sales and other miscellaneous sales. In the United States, our products are available through a network of wholesale accounts comprised of department, athletic and specialty stores. Internationally, our products are available through wholesale accounts in more than 100 countries and territories through our global network of distributors and our Canadian and European subsidiaries. Additionally, 12 distributors opened 38 distributor-owned Skechers retail stores in 16 countries as of December 31, 2005. 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.

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 accounts, 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 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 within each account.

In an effort to provide knowledgeable and personalized service to our wholesale accounts, 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 president and national sales managers report to our senior vice president of sales. All of our vice president 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 sell competing products.

We believe that we have developed a loyal customer base of wholesale accounts through a heightened level of 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 accounts 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 accounts. 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, the Benelux Region and the United Kingdom, (ii) sales of our footwear to more than 30 foreign distributors who distribute such footwear to department stores and specialty retail stores in countries and territories across Eastern Europe, Asia, Latin America, South America, Africa, the Middle East

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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 presence 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.

In regards to our Skechers-owned retail stores in Europe, we have nine concept stores and one factory outlet store located in five countries, including the key locations of Oxford Street in London, Alstadt 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 one concept store located in Toronto's Eaton Centre and one factory outlet store located in Toronto.

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 12 of these distributors, 38 distributor-owned Skechers retail stores are open in 17 countries, including nine stores that were opened in 2005. One distributor-owned store was closed in 2005.

REGION	STORE FORMAT	NUMBER OF STORES	LOCATION⁽¹⁾
<i>Asia</i>	Concept	3	Osaka, Japan; Tokyo, Japan; South Korea
	Warehouse	4	Osaka, Japan (2); Shizuoka, Japan; Tochigi-ken, Japan
<i>Australia</i>	Concept	1	Sydney, Australia
<i>Central America/ South America</i>	Concept	22	Chile (4); Columbia (5); Ecuador; El Salvador; Guatemala (2); Panama (2); Peru; Venezuela (6)
<i>Eastern Europe</i>	Concept	4	Moscow, Russia (3); Kiev, Ukraine
<i>Middle East</i>	Concept	3	Tel Aviv, Israel; Riyadh, Saudi Arabia; Dubai, UAE
<i>South Africa</i>	Concept	1	Sandton, South Africa

(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. This format also allows us to manage our inventory in an efficient and brand sensitive manner. In addition, most of our retail stores are profitable and have a positive effect on our operating results. As of February 28, 2006, we operated 34 concept stores, 56 factory outlet stores and 32 warehouse outlet stores in the United States, and ten concept stores and two warehouse outlet stores internationally. We closed three stores and opened 11 new stores in 2005. We opened one new store in the first two months of 2006, with an additional 15 to 20 stores planned to open by the end of 2006.

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, Santa Monica's Third Street Promenade, Dallas' Northpark Center, Las Vegas' Fashion Show Mall, Seattle's Bellevue Square Mall, Woodfield Mall outside Chicago and international locations include Oxford Street in London, Altstadt District in Dusseldorf and 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 one concept store and closed three others in 2005.

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 1,200 square feet. When deciding where to open concept stores, we identify top geographic markets in the larger metropolitan cities in the United States, Europe and Canada. 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.

In an effort to market and test our non-Skechers brands, we opened a new format of concept store, SoHo Lab. In 2004, we converted an existing Skechers concept store in New York's SoHo District to the new format, removing all Skechers signage and graphics, replacing them with graphics from our fashion and street lines: Michelle K, Mark Nason, 310 Motoring, Unltd. by Marc Ecko and Rhino Red. In 2005, we converted two additional Skechers concept stores in urban and/or fashion locations to SoHo Lab stores, and in 2006, we plan to open four more SoHo Lab locations built from the ground up. The stores may also include more fashion forward Skechers styles.

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 that opened in 2005 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, which could otherwise 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

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supplemented by certain first-line styles sold at full retail price points. We opened nine domestic factory outlet stores in 2005, and one more in the first two months of 2006.

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 14,800 square feet. Our warehouse outlet stores enable us to sell discontinued and excess 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 did not open any new warehouse outlet stores in 2005.

Electronic Commerce. Our e-commerce sales represented less than 1.0% of total net sales in 2005, 2004 and 2003. Our website, www.skechers.com, is a virtual storefront that promotes the Skechers brand name. Designed to provide a positive shopping experience, the website showcases 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, become an efficient and effective additional retail distribution channel, and has 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.

The first launch of Skechers licensed product was Skechers Kids apparel for boys and girls from the licensee, Kids Headquarters, in the United States for the 2003 back-to-school selling season. Due to the successful in-store launch of Skechers Kids, we expanded our licensing agreement with Kids Headquarters to include infant and toddler apparel, boys' and girls' daywear and sleepwear, and swimwear for boys and girls. We also extended our territory for licensed apparel for infants, toddlers and children by signing a licensing agreement with MultiGroup Inc. for design and distribution of Skechers Kids in Canada.

As of February 28, 2006, we had 14 active domestic and international licensing agreements. In addition to our licensing agreement with MultiGroup, we have international licensing agreements with other licensees for the design and distribution of men's and women's active apparel in Israel; for adult and children's active apparel, swimwear, hosiery and accessories in Japan; and new in 2005, bags in select Central and South American countries and watches in the Philippines. We have also signed an agreement for Skechers bags in China, which are expected to begin shipping in 2006.

We have signed agreements to design, develop and market footwear for the street lifestyle apparel brands, Ecco Unltd., Ecco Red and Zoo York under the Marc Ecco Enterprises umbrella and for Kitson, the ultra-hip Hollywood boutique.

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 and are shipped either (i) to our approximately 1.4 million square-foot internally managed distribution center located in Ontario, California, (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. 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.

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The following table sets forth a summary of our distribution facilities:

ADDRESS	STATUS	SQUARE FOOTAGE
Avenue du parc Industriel, Liege, Belgium	Leased since July 2002	241,700
4100 East Mission Blvd., Ontario, CA	Leased since June 2001	763,300
1670 Champagne Avenue, Ontario, CA	Owned since October 2000	263,700
1661 South Vintage, Avenue, Ontario, CA	Leased since November 1997	127,800
1777 South Vintage, Avenue, Ontario, CA	Leased since November 1997	284,600
		1,681,100

We believe that we have the capacity at our Ontario distribution center to increase our current operations to meet any future growth, and if we should ever need to expand our distribution facilities to allow for further growth, we believe there is presently enough space available in close proximity that leads us to believe leasing or purchasing additional property will not be a problem in the foreseeable future.

Our lease agreement for our Liege, Belgium distribution center provides for first right of refusal on three remaining facilities planned for development, allowing for expansion of up to approximately 735,000 square feet. We believe that the capacity available to us within this lease agreement will allow for further growth of our international operations.

BACKLOG

As of December 31, 2005, our backlog was \$250.5 million, compared to \$220.5 million as of December 31, 2004. 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 2006. However, for a variety of reasons, including 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. In addition, cancellation rates that we have realized in the past may not be indicative of cancellation rates to be expected in the future.

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. 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

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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. and Wolverine World Wide, Inc. Our athletic shoes compete with brands of athletic footwear offered by companies such as Nike, Inc., Reebok International Ltd., Adidas-Salomon AG, Puma AG and New Balance Athletic Shoe, Inc. Our children's shoes compete with brands of children's footwear such as those offered by The Stride Rite Corporation. 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.

EMPLOYEES

As of February 28, 2006, we employed 2,997 persons, 1,680 of whom were employed on a full-time basis and 1,317 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.

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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. 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 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 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 2005, 2004 and 2003, our net sales to our five largest customers accounted for approximately 25.4%, 26.8% and 27.7% of total net sales, respectively. No customer accounted for more than 10% of our net sales during 2005, 2004 and 2003. One customer accounted for 10.3% and 10.9% of net trade receivables at December 31, 2005 and December 31, 2004, 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 in excess of amounts that we have insured. 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 in excess of amounts insured, our business could be harmed.

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, 2005 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 risks: political and social unrest, including the military presence in Iraq;

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changing economic conditions; currency exchange rate fluctuations; international political tension and terrorism; labor shortages and work stoppages; electrical shortages, transportation delays; loss or damage to products in transit; expropriation; nationalization; the imposition of domestic and international tariffs and trade duties, import 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, adverse changes in trade or political relations with China, political instability in China, the occurrence of a natural disaster such as an earthquake or hurricane in China or the outbreak of a pandemic disease such as Severe Acute Respiratory Syndrome (SARS) or the Avian Flu in China would severely interfere with the manufacture 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.

Also, 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 valuation of the Yuan may 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.

The Potential Imposition Of Additional Duties, Tariffs And Other Trade Restrictions, Including The European Union's Anticipated Anti-Dumping Duties On Leather Footwear Made In China And Vietnam, 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, anti-dumping duties, quotas, safeguard measures 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.

Following the phase-out at the beginning of 2005 of quotas that had been imposed by the EU since 1994 on the import of certain types of footwear manufactured in China, and the expiration of a separate EU anti-dumping case in 2003 against footwear made in China, Indonesia and Thailand, there has been renewed pressure from the EU footwear manufacturing industry to re-impose some level of trade protection on imported footwear from China, India, Vietnam and other exporting countries. In mid-2005, the EU Trade Commission initiated an anti-dumping investigation into leather footwear imported from China and Vietnam. Along with other major footwear manufacturers, we have been actively participating as respondents in this investigation and are taking the position that certain categories of footwear should not be within the product scope of this investigation and do not meet the legal requirements of injury and price in an anti-dumping investigation, as part of our efforts to minimize any adverse financial impact on our results of operations in 2006 and beyond. We believe that our major competitors stand in much the same position of risk regarding these potential trade measures.

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

Although our company has generally exhibited steady growth since we started our business, we had a decrease in size in the past and our rate of growth has declined at times as well, and we may experience similar decreases in size 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. Furthermore, as our business becomes larger, we may not be able to effectively manage our growth. We anticipate that as our business continues to grow, we will have to improve

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and enhance our overall financial and managerial controls, reporting systems and procedures. 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.

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 that affect not only the ultimate consumer, but also retailers, 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. As a result, our operating results may be adversely and materially affected by downward trends in the economy or the occurrence of events that adversely affect the economy in general. 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 fixed in the short term, our operating results and margins will be adversely impacted if we do not continue to grow as anticipated. For example, due in large part to the slowdown in the global economy, our net sales for 2003 were lower than anticipated. This lower level of sales adversely affected our operating results for 2003 and could do so again in 2006 and beyond.

Economic, Political, Military Or Other Events In The United States Or In A Country Where We Make Significant Sales Or Have Significant Operations Could Interfere With Our Success Or Operations There And Harm Our Business.

We market and sell our products and services throughout the world. The September 11, 2001 terrorist attacks disrupted commerce throughout the United States and other parts of the world. The continued threat of similar attacks throughout the world 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. To the extent that such disruptions further slow the global economy or, more particularly, result in delays or cancellations of purchase orders for our products, our business and results of operations could be materially adversely affected. We are unable to predict whether the threat of new attacks or the responses thereto will result in any long-term commercial disruptions or if such activities or responses will have a long-term material adverse effect on our business, results of operations or financial condition.

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 and 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. Also, 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.

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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 2005 and 2004, the top four manufacturers of our products produced approximately 59.7% and 56.1% of our total purchases, respectively. One manufacturer accounted for 32.4% and 28.2% of total purchases during 2005 and 2004, respectively. A second manufacturer accounted for 11.2% and 11.0% of our total purchases during 2005 and 2004, respectively. 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 United States and foreign 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 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 hedge this risk by offering a broad range of products, and no style comprised over 5% of our gross wholesale sales during 2005 or 2004. 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.

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.

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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 Trademarks, Design Patents And Other Intellectual Property Rights May Not Be Adequately Protected Outside The United States.

We believe that our trademarks, design patents and other proprietary rights are important to our success and our competitive position. We devote substantial resources to the establishment and protection of our trademarks and design patents on a worldwide basis. In the course of our international expansion, we have, however, experienced conflicts with various third parties that have acquired or claimed ownership rights in certain trademarks similar to ours or have otherwise contested our rights to our trademarks. We have in the past successfully resolved these conflicts through both legal action and negotiated settlements, none of which we believe has had a material impact on our financial condition and results of operations. Nevertheless, we cannot assure you that the actions we have taken to establish and protect our trademarks and other proprietary rights

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outside the United States will be adequate to prevent imitation of our products by others or to prevent others from seeking to block sales of our products as a violation of the trademarks and proprietary rights of others. Also, we cannot assure you that others will not assert rights in, or ownership of, trademarks, designs and other proprietary rights of ours or that we will be able to successfully resolve these types of conflicts to our satisfaction. In addition, the laws of certain foreign countries may not protect proprietary rights to the same extent as do the laws of the United States. 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 may be adversely affected.

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 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, which we utilize in marketing our products. We continue to vigorously protect our trademarks against infringement. We also have a number of design patents and a limited number of utility patents covering components and features used in various shoes. We believe that our success depends primarily upon skills in design, research and development, production and marketing rather than upon our patent position. However, we have followed a policy of filing applications for United States and foreign patents on designs and technologies that we deem valuable.

We believe that our patents and trademarks are generally sufficient to permit us to carry on our business as presently conducted. We cannot, however, know whether 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 face the risk of ineffective protection of intellectual property rights in the countries where we source and distribute our products. We have been sued for patent and trademark infringement and cannot be sure that our activities do not and will not infringe on the proprietary 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 and necessary management attention to such matters, which could negatively impact our business or financial condition.

Obtaining Additional Capital To Fund Our Operations And Finance Our Growth Could Make It Difficult For Us To Service Our Debt Obligations.

If our working capital needs exceed our current expectations, we may need to raise additional capital through public or private equity offerings or debt financings. If we cannot raise needed funds on acceptable terms, we may not be able to successfully execute our growth strategy, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements. To the extent we raise additional capital by issuing debt, it may become difficult for us to meet debt service obligations. To the extent we raise additional capital by issuing equity securities, our stockholders may experience substantial dilution. Also, any new equity securities may have greater rights, preferences or privileges than our existing Class A Common Stock.

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 38 of our retail stores, our headquarters in Manhattan Beach and our domestic distribution center in Ontario. 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.

Failure By Us To Comply With Any Of The Financial Covenants In Our Long-Term Debt Agreements And \$150 Million Line Of Credit Facility Could Have A Material Adverse Impact On Our Business.

A significant decrease in our operating results could adversely effect our ability to maintain required financial covenants under our various long-term debt agreements and our \$150 million credit facility. If these financial covenants are not maintained, the creditors will have the option to require immediate repayment of all outstanding long-term debt and any amounts outstanding under the credit facility, if any, and some of these agreements also contain cross-default provisions. The most likely result would require us to renegotiate certain terms of these agreements, obtain waivers from the creditors or obtain new debt agreements with other creditors, which may contain less favorable terms. If we are unable to renegotiate acceptable terms, obtain necessary waivers or obtain new debt agreements, this could have a material adverse effect on our business, results of operations and financial condition.

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Recognizing Compensation Expense Related To Stock Options Under FASB Statement 123(R) Will Reduce Our Future Reported Earnings.

The Financial Accounting Standards Board (FASB) has issued a new accounting standard (Statement 123(R)) requiring companies to begin recognizing compensation expense related to all unvested and newly granted stock options. We included such expenses on a pro forma basis in the notes to our quarterly and annual financial statements through December 31, 2005 in accordance with U.S. GAAP and did not include compensation expense related to stock options in reported earnings. We adopted Statement 123(R) on January 1, 2006 as required. Thus, our reported earnings will be lower in 2006 and thereafter than they would otherwise be under the previous accounting treatment for stock options, and as a result, the trading price of our Class A Common Stock could decline.

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, 2005, Robert Greenberg, Chairman of the Board and Chief Executive Officer, beneficially owned 73.5% 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, 2005, Mr. Greenberg beneficially owned approximately 64.5% 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 87.5% of the aggregate number of votes eligible to be cast by our stockholders. Therefore, Mr. Greenberg is able to control substantially all matters requiring approval by our 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 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.

We Are Still Exposed To Potential Risks From Recent Legislation Requiring Public Companies To Evaluate Controls Under Section 404 Of The Sarbanes-Oxley Act Of 2002.

We are subject to various regulatory requirements, including the Sarbanes-Oxley Act of 2002. We, like all other public companies, are incurring expenses and, to a lesser extent, diverting management's time in an effort to comply with Section 404 of the Sarbanes-Oxley Act of 2002. We have implemented processes documenting and evaluating our system of internal controls. If, in the future, management identifies one or more material weaknesses, or our external auditors are unable to attest that our management's report is fairly stated or to express an opinion on the effectiveness of our internal controls, this could result in a loss of investor confidence in our financial reports, have an adverse effect on our stock price and/or subject us to sanctions or investigation by regulatory authorities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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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 leased property expires between February 2007 and October 2010, with options to extend these leases in some cases, and the current aggregate annual rent for the leased property is approximately \$0.4 million. Also, construction commenced in 2005 on another corporate facility in Manhattan Beach, California that is expected to be approximately 55,000 square feet. This facility is scheduled to be completed by the end of 2007.

Our U.S. distribution center consists of four facilities located in Ontario, California. The three leased facilities aggregate approximately 1,176,000 square feet, with an annual base rent of approximately \$4.2 million. The leased property expires between November 2007 and May 2011, and these leases contain rent escalation provisions. The owned distribution facility is approximately 264,000 square feet.

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 \$1.1 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 at five-year intervals beginning in February 2007, pending notification as prescribed in the lease.

All of our domestic retail stores and showrooms are leased with terms expiring between February 2006 and September 2018. 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 \$17.8 million for the year ended December 31, 2005.

We also lease all of our international administrative offices, retail stores and showrooms located in Canada, France, Germany, Switzerland, Italy, Spain, the Netherlands and the United Kingdom. The leased properties expire at various dates between July 2006 and September 2018. Total rent for the leased properties aggregated approximately \$6.0 million for 2005.

ITEM 3. LEGAL PROCEEDINGS

On December 2, 2002, a class action complaint entitled *OMAR QUINONES v. SKECHERS USA, INC. et al.* was filed in the Superior Court for the State of California for the County of Orange (Case No. 02CC00353). The complaint, as amended, alleges overtime and related violations of the California Labor Code on behalf of managers of Skechers retail stores and seeks, inter alia, damages and restitution, as well as injunctive and declaratory relief. On February 25, 2003, another related class action complaint entitled *MYRNA CORTEZ v. SKECHERS USA, INC. et al.* was filed in the Superior Court for the State of California for the County of Los Angeles (Case No. BC290932), asserting similar claims and seeking similar relief on behalf of assistant managers. On July 7, 2004, a third class action complaint entitled *MYRNA CORTEZ et al. v. SKECHERS USA, INC. et al.* was filed in the Superior Court for the State of California for the County of Los Angeles (Case No. BC318101). The complaint alleges wage violations of the California Labor Code and unfair business practices relating to deductions for uniforms on behalf of employees of Skechers retail stores and seeks, inter alia, damages and civil penalties, as well as injunctive relief. On December 20, 2004, the parties agreed to a preliminary settlement that fully resolved all claims brought by the plaintiffs in each of the three lawsuits. Under the terms of the preliminary settlement, Skechers was to pay a potential maximum settlement amount of approximately \$1.8 million, which was recorded to other expense in the consolidated statement of earnings during the fourth quarter of 2004, to cover claims made by eligible class members, plaintiff attorneys' fees and costs, and costs of a third-party administrator. On July 18, 2005, the court approved the preliminary settlement, and all claims from eligible class members have been received. The final settlement payout, which was within the \$1.8 million amount that was accrued and reserved, was \$1.6 million.

On March 25, 2003, a shareholder securities class action complaint captioned *HARVEY SOLOMON v. SKECHERS USA, INC. et al.* was filed against Skechers 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 Skechers 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 Skechers 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 Skechers

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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 Skechers 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 Skechers 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 Skechers 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 Skechers between April 3, 2002 and December 9, 2002. The complaint seeks compensatory damages, interest, attorneys fees and injunctive and equitable relief. Skechers moved to dismiss the consolidated complaint in its entirety. On May 10, 2004, the court granted Skechers 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. Skechers 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 Skechers 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 date of filing this annual report, all briefing by the parties has been completed and the parties are waiting on a hearing date. Discovery has not commenced in the underlying action. While it is too early to predict the outcome of the appeal and any subsequent litigation, Skechers believes the suit is without merit and intends to vigorously defend against the claims.

On April 3, 2003, a shareholder derivative complaint captioned BRADFORD MITCHELL v. JEFFREY GREENBERG et al. was filed against Skechers and certain of its officers in the Superior Court of the State of California, Los Angeles County (Case No. BC 293317). On April 3, 2003, a shareholder derivative complaint captioned GEORGIA MANOLAS v. JEFFREY GREENBERG et al. was filed against Skechers and certain of its officers in the Superior Court of the State of California, Los Angeles County (Case No. BC293388). On April 8, 2003, a shareholder derivative complaint captioned JEFF GRAVITTER v. ROBERT Y. GREENBERG was filed against Skechers and certain of its officers in the Superior Court of the State of California, Los Angeles County (Case No. BC293561). Each of these class action complaints included allegations of violations of California Corporation Code § 25402 and breach of fiduciary duty. On August 29, 2003, the plaintiffs in these state derivative actions filed a consolidated complaint entitled In re SKECHERS USA, Inc. Derivative Litigation, Case No. BC-293317, in the Superior Court of the State of California, Los Angeles County, consolidating all of the state derivative actions above. The complaint alleges violations of California Corporation Code §25402, breaches of fiduciary duty, waste of corporate assets and unjust enrichment. The complaint sought compensatory damages, treble damages, disgorgement of profits, imposition of a constructive trust, equitable and injunctive relief, and costs. The matter had been settled in principle and a settlement stipulation between the parties had been signed, although the settlement was subject to court approval. On June 3, 2005, the court declined to approve the proposed settlement, although the court stated that the parties are free to settle the case between each other without formal court approval and indeed are encouraged to do so. In response, the parties revised the stipulation of settlement and opted to give the shareholders notice of settlement. The parties sought court approval of the revised settlement, and the court approved such settlement on December 19, 2005. The settlement was funded entirely by Skechers insurance carrier.

On May 19, 2005, Rosemary Almanza filed a lawsuit against Skechers in the Superior Court of the State of California, County of San Bernadino, ROSEMARY ALMANZA v. SKECHERS U.S.A., INC. (Case No. RCV

087714). The complaint alleges wrongful termination under the California Fair Employment and Housing Act, California Government Code §12900, et seq., as a result of harassment, discrimination and retaliation against Ms. Almanza. The complaint seeks compensatory damages, punitive and exemplary damages, interest and attorneys fees. Skechers plans on defending the allegations vigorously and believes the claims are without merit. On February 20, 2006, the parties settled the suit, and the settlement did not have a material adverse effect on our company's financial condition or results of operations.

On September 23, 2005, Gary Palmer filed a lawsuit in United States District Court, Eastern District of California against Chelsea Financing Partnership, L.P., which is the owner of an outlet mall in Folsom, California, and 71 retailers including Skechers located in the outlet mall (Case No. 2:05-cv-01935-MCE-GGH). The complaint alleges that Chelsea Financing Partnership, L.P. and the retailers have violated the Americans with Disabilities Act of 1990, the Disabled Persons Act and the Unruh Civil Rights Act by failing to make the facilities fully and equally accessible to handicapped individuals, and that such violations discriminate against

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plaintiff. The complaint seeks injunctive and preventive relief, declaratory relief, actual and statutory damages, exemplary damages and attorneys' fees from the defendants. On December 14, 2005, the parties settled the suit, and the settlement did not have a material adverse effect on our company's financial condition or results of operations.

On December 21, 2005, Twelve Ten Studios, Inc. filed a lawsuit against Skechers in United States District Court, Central District of California, TWELVE TEN STUDIOS, INC. v. SKECHERS U.S.A., INC. (Case No. CV 05008863). The complaint alleges copyright infringement for use of an embroidered fabric design authored by plaintiff for use on women's footwear in 2003. The complaint seeks injunctive relief, compensatory damages, punitive and exemplary damages, interest, and attorneys' fees and costs. Although Skechers believed the case was without merit, the style at issue was insignificant and the matter was settled on a confidential basis to avoid costly and protracted litigation. Skechers does not believe the settlement will have a material adverse effect on our company's financial condition or results of operations.

Skechers occasionally becomes involved in litigation arising from the normal course of business and we are unable to determine the extent of any liability that may arise. Other than the foregoing, we have 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 our company's consolidated financial statements or results of operations.

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 2005.

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.

	HIGH	LOW
YEAR ENDED DECEMBER 31, 2005		
First Quarter	\$ 16.90	\$ 12.80
Second Quarter	15.62	11.18
Third Quarter	18.19	13.94
Fourth Quarter	16.50	12.00
YEAR ENDED DECEMBER 31, 2004		
First Quarter	\$ 13.31	\$ 7.51
Second Quarter	14.55	10.17
Third Quarter	15.25	11.56
Fourth Quarter	15.25	10.60

As of March 1, 2006, there were 110 holders of record of our Class A Common Stock (including holders who are nominees for an undetermined number of beneficial owners) and 23 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.

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.

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

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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, 2005.

SUMMARY FINANCIAL DATA
(IN THOUSANDS, EXCEPT EARNINGS PER SHARE)

	YEARS ENDED DECEMBER 31,				
	2005	2004	2003	2002	2001
STATEMENT OF EARNINGS DATA:					
Net sales	\$ 1,006,477	\$ 920,322	\$ 834,976	\$ 943,582	\$ 960,385
Gross profit	420,482	370,857	317,686	386,673	406,180
Royalty income, net	6,628	7,060	4,170	1,145	(303)
Operating expenses:					
Selling	81,378	79,673	84,653	94,274	111,401
General and administrative	269,436	248,999	238,550	210,889	205,989
Earnings (loss) from operations	76,296	49,245	(1,347)	82,655	88,487
Interest expense, net	4,786	7,973	8,839	8,927	13,852
Earnings (loss) before income taxes	72,797	38,720	(10,373)	75,341	75,955
Net earnings (loss)	44,717	23,553	(11,867)	47,036	47,270
Net earnings (loss) per share:(1)					
Basic	\$ 1.13	\$ 0.61	\$ (0.31)	\$ 1.26	\$ 1.30
Diluted	\$ 1.06	\$ 0.59	\$ (0.31)	\$ 1.20	\$ 1.24
Weighted average shares:(1)					
Basic	39,686	38,638	37,840	37,275	36,409
Diluted	44,518	39,800	37,840	40,854	38,059

AS OF DECEMBER 31,

BALANCE SHEET DATA:	2005	2004	2003	2002	2001
Working capital	\$ 361,210	\$ 313,883	\$ 275,124	\$ 286,760	\$ 139,972
Total assets	581,957	518,653	466,533	483,156	407,486
Long-term debt, excluding current portion	107,288	113,038	116,047	117,204	29,616
Stockholders' equity	343,830	294,895	255,654	259,236	199,016

- (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, unless their inclusion would be anti-dilutive.

Table of Contents**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 seven other unique brand names. 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 have the following three reportable sales segments—domestic wholesale sales, international wholesale sales and retail sales. In addition, we report an All other segment, which includes our e-commerce sales and other miscellaneous sales. We evaluate segment performance based primarily on net sales and gross margins. See detailed segment information in footnote 12 to our consolidated financial statements included under Part II, Item 8 of this annual report.

FINANCIAL OVERVIEW

Our net sales for 2005 increased \$86.2 million, or 9.4% percent, to \$1.006 billion from \$920.3 million in 2004. Our strong performance in 2005 was the result of our dedicated efforts to consistently deliver trend-right styles, which has led to an increased demand for our in-season product and continued growth in our fashion and street lines. Our domestic wholesale segment is our largest distribution channel comprising 63.0%, 63.3%, and 67.4% of our consolidated net sales for the years ended December 31, 2005, 2004 and 2003, respectively. Our international wholesale sales comprised 16.3%, 17.0%, and 14.6% of our consolidated net sales for the years ended December 31, 2005, 2004 and 2003, respectively. Retail sales comprised 20.0%, 19.2%, and 17.3% of our consolidated net sales for the years ended December 31, 2005, 2004 and 2003, respectively, of which our domestic retail sales comprised 18.4%, 17.6%, and 16.0% of our consolidated net sales for the years ended December 31, 2005, 2004 and 2003, respectively. Our international retail sales did not comprise more than 10% of our consolidated net sales in 2005, 2004 or 2003.

Domestic wholesale unit sales volume increased 8.1% to 34.4 million pairs in 2005 from 31.8 million pairs in 2004, and our average selling price per pair increased 0.8% to \$18.45 in 2005 from \$18.31 in 2004. These increases in average selling price per pair and increase in unit sales volume were due to the continued improvement and favorable response to our in-season product in 2005.

We achieved diluted earnings per share of \$1.06 on net sales of \$1.006 billion in 2005. Our higher net sales and profitability for 2005 as compared to 2004 are primarily attributable to stronger than anticipated sales of in-line product, increased margins due to a shift in sales to our higher margin business units, increased international wholesale and retail sales, and a reduction in selling expenses as a percentage of net sales. We had working capital of \$361.2 million at December 31, 2005, an increase of \$47.3 million from working capital of \$313.9 million at December 31, 2004. We generated an increase of \$59.3 million in cash during 2005 bringing our cash balance to \$197.0 million at year end compared to \$137.7 million at December 31, 2004.

These positive results are being driven by focusing on our core strengths and 2005 initiatives which included:

New product design and delivery. Our success depends on our ability to frequently introduce new styles and product lines as well as 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 the line in upcoming seasons. Our focus in 2005 was primarily on updating many key sellers in our current lines and growing our product offering for our recently launched fashion and street lines: 310 Motoring, Unltd. by Marc Ecko and Rhino Red. In addition, we also introduced two new product lines: Kitson for women and girls, and Siren by Mark Nason for women.

We will continue to broaden our product offering with new lines that 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 enter into new doors without detracting from existing business. Recently, we announced a licensed line of footwear for Zoo York, which is one of the leading action sport apparel brands, that we expect to introduce for the 2006 back-to-school selling season.

Building our brands. As a marketing-driven company, we consistently focus on advertising the Skechers brands in targeted publications, on key television programming and in high traffic areas and key malls. During 2005, we capitalized on our presence with

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celebrity endorsee driven ads first with the worldwide Christina Aguilera campaign that concluded in June, and then with the launch of our new Skechers celebrity endorsee, rising star and American Idol winner Carrie Underwood. We believe Ms. Underwood's appeal and popularity will have a positive impact on our brand and create further demand for our product as her debut album remains one of the top albums in the United States. In addition, the launch of television sponsorship campaigns for our Skechers men's, women's and children's lines will further grow our brand with our diverse consumer base.

Our goal with our fashion and street lines is to increase brand recognition through the continued presence of print and television advertising in targeted markets. Depending on need, each brand has its own print campaign and some may have additional forms of marketing, such as television. Of the seven brands that comprise this division, Unltd. by Marc Ecko and Rhino Red are globally recognized brands, Michelle K and Mark Nason are becoming more established through several years of marketing efforts, and 310 Motoring and Kitson are brands with rapidly growing recognition. With the appeal and uniqueness of the 310 Motoring brand, we were able to develop a signature line of sneakers with multi-platinum hip hop recording artist The Game, which has resulted in a complete marketing program featuring him. In addition, we signed an endorsement deal with Oscar-nominated actor Terrence Howard to support our 310 Motoring brand. We believe that these campaigns, including the 310/Game campaign, should generate additional demand for our fashion and street products in 2006.

Targeted approach to licensing. We have signed select licensing deals in the United States and abroad to further grow and enhance the image of the Skechers brand. Our most significant domestic license to date is with Kids Headquarters for Skechers Kids apparel, daywear and sleepwear, which launched for the back-to-school selling season in 2003. We have also signed licensing agreements for apparel and/or accessories in Japan, Israel, China, Philippines, and Central and South America. We believe these licenses will have a positive impact on our brand in these international markets.

Further develop international businesses. In 2005, we continued to focus on improving our international operations by (i) increasing our customer base within our subsidiary business, (ii) increasing the product count within each account, (iii) delivering the right product into the right markets, specifically with our distributor business and (iv) tailoring our product offerings currently available to our international customers to increase demand for our product. Our international business is supported by eight subsidiaries that sell direct to wholesale accounts in 11 countries in Europe and in Canada. We believe the continued strength of our international business is a direct result of a broader acceptance of our trend-right product and increases in style counts. We believe most of our distributors have implemented appropriate product and marketing efforts, which positions them to improve their businesses in 2006. We expect countries where distributors have opened Skechers retail stores to benefit the most from these efforts.

Further grow our company-owned retail business. With a focus on profitably growing our retail business, in 2005 we increased our store count by eight stores, and we opened one additional store in Utah in the first two months of 2006, bringing our domestic and international store count to 134. We have seen double digit comparable store sales growth in our domestic retail business during 2005 and believe that it will continue to grow as we expand into new domestic markets. We plan to open another 15 to 20 stores in 2006.

Continued management of expenses. We continue to focus on cost management and are dedicated to growing profitably. In 2005, our selling and general and administrative expenses declined slightly as a percentage of net sales. In addition, we saw improved gross margins as a result of improved management of our inventory levels as well as a shift in sales to our higher margin business units.

YEAR ENDED DECEMBER 31, 2005 COMPARED TO THE YEAR ENDED DECEMBER 31, 2004

Net sales

Net sales for 2005 were \$1.006 billion, an increase of \$86.2 million, or 9.4%, over net sales of \$920.3 million in 2004. The increase in net sales was due to increased domestic wholesale sales, retail sales and increased direct international sales in Germany, Spain, Benelux, Italy and Canada, offset by decreased sales in the United Kingdom and France. Our domestic wholesale segment increased 8.9%, or \$52.1 million, to \$634.3 million compared to \$582.2 million in 2004. The increase in domestic wholesale segment net sales came on a 8.1% unit sales volume increase to 34.4 million pairs from 31.8 million pairs in 2004. Our average selling price per pair increased 0.7% to \$18.45 from \$18.31 in 2004. 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. The strongest increases came in our Women's Active, Mark Ecko, and Men's USA lines.

Our retail segment sales increased \$24.8 million to \$201.6 million in 2005, a 14.0% increase over sales of \$176.8 million in 2004. The increase in retail sales was due to a net increase of eight stores, increased sales across all three store formats and positive

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comparable store sales. During 2005, we opened ten new domestic stores, one international store and closed three other domestic stores. These new stores contributed \$4.6 million in net sales during 2005. Of our new store additions, ten were outlet stores and one was a concept store. In addition, during 2005, we realized positive comparable store sales increases in our domestic and international retail stores of 16.9% in our concept stores comparable sales and 3.7% in our international store comparable sales. Our domestic retail sales increased 14.7% due to positive comparable sales and having four retail stores that were opened in 2004 being open the entire year in 2005. Our international retail sales increased 6.7% in 2005 compared to 2004, due to increased comparable sales, the opening of one additional store, as well as favorable currency translation adjustments. We currently anticipate opening one international retail store in 2006.

We currently have 122 domestic retail stores, and we believe that we have a presence in most major markets. We currently plan to open between approximately 15 to 20 domestic retail stores in 2006. During 2005 we closed three under-performing retail stores as compared to closing four retail stores in 2004. We periodically review all of our stores for impairment. During 2005, we recorded an impairment charge of \$0.9 million related to leasehold improvements for two of our stores. 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 international wholesale segment sales increased \$7.0 million to \$163.5 million in 2005, a 4.5% increase over sales of \$156.5 million in 2004. 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. The increase in international wholesale sales was primarily due to increased direct subsidiary sales, which were partially offset by reduced distributor sales. Direct subsidiary sales increased \$11.1 million, or 15.4%, to \$83.4 million compared to net sales of \$72.3 million in 2004. The increase in direct subsidiary sales was primarily due to increased sales into Germany, Canada, Spain and Italy. Our distributor sales decreased \$4.1 million to \$80.1 million in 2005, a 4.9% decrease over sales of \$84.2 million in 2004. This was primarily due to decreased sales into Japan.

Our e-commerce sales, included in our All other segment, increased \$2.2 million to \$7.0 million in 2005, a 46.0% increase over sales of \$4.8 million in 2004. Our e-commerce sales made up less than 1% of our consolidated net sales in both 2005 and 2004.

Gross profit

Gross profit for 2005 increased \$49.6 million to \$420.5 million as compared to \$370.9 million in 2004. Our domestic wholesale segment increased \$18.0 million, or 8.4%, to \$232.4 million in 2005 compared to \$214.4 million in 2004. Gross profit as a percentage of net sales, or gross margin, increased to 41.8% in 2005 from 40.3% in 2004. This gross margin increase was the result of the increase in international wholesale margins, which increased to 37.2% in 2005 from 34.6% for 2004, and as a result of retail sales becoming a larger portion of consolidated net sales, which achieve higher gross margins than our wholesale sales. Increased margins was also a result of increased demand for our in-season products and broader acceptance of our new lines, including sport fusion and casual fusion footwear.

Gross profit for our retail segment increased \$22.5 million, or 22.2%, to \$123.9 million in 2005 as compared to \$101.4 million in 2004. This increase in gross profit was due to four stores that were opened in 2004 being open the entire year in 2005 and positive comparable store sales increases of 3.7% and 16.9% in our international and domestic stores, respectively. During 2005, we opened ten new domestic stores, one international store and closed three other domestic stores. Gross margins increased to 61.5% in 2005 as compared to 57.4% in 2004. The increase in margin was primarily due to a larger portion of our retail sales coming from our higher margin concept stores and positive comparable store sales increases.

Gross profit for our international wholesale segment increased \$6.7 million, or 12.4%, to \$60.8 million for 2005 compared to \$54.1 million in 2004. Gross margins were 37.2% for 2005 compared to 34.6% in 2004. The increase in gross margins was primarily due to increased margins in our distributor business. The increase in distributor gross margins was primarily due to stronger sales of in-line merchandise and better product sell-throughs. 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% for both 2005 and 2004.

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.

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Net licensing royalties decreased \$0.5 million, or 7.0%, to \$6.6 million for 2005 compared to \$7.1 million in 2004. 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 \$1.7 million, or 2.1%, to \$81.4 million for 2005 from \$79.7 million in 2004. As a percentage of net sales, selling expenses were 8.1% and 8.7% in 2005 and 2004, respectively. Selling expenses consist primarily of the following accounts: 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.

The increase in selling expenses was primarily due to increased media advertising expenses of \$3.2 million and increased sales commissions of \$1.0 million, partially offset by lower sales representative samples of \$1.6 million and trade show and catalog expenses of \$0.9 million.

General and administrative expenses

General and administrative expenses increased by \$20.4 million, or 8.2%, to \$269.4 million for 2005 from \$249.0 million in 2004. As a percentage of sales, general and administrative expenses were 26.8% and 27.1% in 2005 and 2004, respectively. General and administrative expenses consist primarily of the following: salaries, wages and related taxes, various overhead costs associated with our corporate staff, 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, amongst other expenses. Our distribution network related costs are included in general and administrative expenses and are not allocated to segments.

The increase in general and administrative expenses was primarily due to increased salaries and wages and related payroll costs of \$11.2 million, increased depreciation and repairs and maintenance for our stores of \$2.5 million, and increased warehouse and distribution costs of \$1.7 million. In addition, expenses related to our distribution network, including the functions of purchasing, receiving, inspecting, allocating, warehousing and packaging our products totaled \$70.5 million and \$71.3 million for 2005 and 2004, respectively. Impairment charges related to the write-off of leasehold improvements at one of our domestic and one international retail stores was \$0.9 million in 2005 as compared to \$40,000 for the same period last year.

We believe that we have established our presence in most major domestic and international retail markets. We opened ten domestic and one international retail stores in 2005 while closing three other stores. We currently plan to open between 15 to 20 domestic stores in 2006. In addition, we currently believe that we have sufficiently developed our international direct selling efforts; therefore, we currently do not anticipate entering any new international markets in 2006. Instead, we will focus on (i) enhancing the efficiency of our international operations, (ii) increasing our customer base, (iii) increasing the product count within each customer and (iv) tailoring our product offerings currently available to our international customers to increase demand for our product.

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 2006.

Interest income (expense)

Net interest expense for 2005 decreased \$3.2 million to \$4.8 million for 2005 compared to net interest expense of \$8.0 million in 2004. Interest expense is derived from our convertible notes, mortgages on our distribution center, our corporate office located in Manhattan Beach, California, our capital lease obligations and interest on amounts owed to our foreign manufacturers. The reduction in net interest expense is due to the amortized reduction of our long-term debt and capital leases as well as increased interest income due to increased short-term interest rates and increased cash balances during 2005.

Table of Contents***Other income (expense)***

Other income, net increased \$3.9 million to \$1.3 million for 2005, compared to \$2.6 million expense in year 2004. The increase in other income was due to recoveries related to the settlement of various lawsuits for \$1.6 million during 2005 as compared to settlement payments of \$2.3 million in 2004.

Income taxes

The effective tax rate for 2005 was 38.6% as compared to 39.2% in 2004. Income tax expense for 2005 was \$28.1 million compared to \$15.2 million for 2004. The tax provision was computed using the effective tax rates applicable to each of our domestic and international taxable jurisdictions. The 2005 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 United States Internal Revenue Service. As such, we did not provide for deferred income taxes on accumulated undistributed earnings of our non-U.S. subsidiaries.

YEAR ENDED DECEMBER 31, 2004 COMPARED TO THE YEAR ENDED DECEMBER 31, 2003

Net sales

Net sales for 2004 were \$920.3 million, an increase of \$85.3 million, or 10.2%, over net sales of \$835.0 million in 2003. The increase in net sales was due to increased wholesale sales, retail sales and increased direct international sales in the United Kingdom, Germany, Spain, Benelux, Italy and Canada, offset by decreased sales in France. Our domestic wholesale segment increased 3.3%, or \$19.3 million, to \$582.2 million compared to \$562.9 million in 2003. The increase in domestic wholesale segment net sales came on a 4.8% unit sales volume decrease to 31.8 million pairs from 33.4 million pairs in 2003 offset by an increase in our average selling price per pair of 8.6% to \$18.31 from \$16.86 in 2003. The increase in average selling price per pair and the decrease in unit sales volume were due to the reduced level of markdown and closeout merchandise in 2004, when compared to 2003, when we were focused on reducing our inventory levels.

Our retail segment sales increased \$32.2 million to \$176.8 million in 2004, a 22.3% increase over sales of \$144.6 million in 2003. The increase in retail sales was due to the increase in warehouse and factory outlet stores and positive comparable store sales ranging from 2.5% to 16.9%. During 2004, we opened four new domestic stores and closed four other domestic stores. These new stores contributed \$2.5 million in net sales during 2004. Of our new store additions, three were outlet stores and one was a warehouse store, which tend to have higher average sales per store than our concept stores. In addition, during 2004, we realized positive comparable store sales increases in many of our domestic and international retail stores ranging from an increase of 2.5% in our warehouse stores comparable sales to an increase of 16.9% in our international store comparable sales. Our domestic retail sales increased 20.5% due to positive comparable store sales and having an additional twenty-three retail stores that were opened in 2003 being open the entire year in 2004. Our international retail sales increased 44.6% in 2004 compared to 2003, due to increased comparable sales, six stores opened in 2003 being open the entire year of 2004, as well as favorable currency translation adjustments.

Our international wholesale segment sales increased \$34.9 million to \$156.5 million in 2004, a 28.7% increase over sales of \$121.6 million in 2003. The increase in international wholesale sales was due to increased distributor and direct subsidiary sales. Our distributor sales increased \$16.1 million to \$84.2 million in 2004, a 23.6% increase over sales of \$68.1 million in 2003. This was primarily due to increased sales into Japan, Panama, Chile, the Philippines and Australia. Our international direct sales increased \$18.8 million to \$72.3 million in 2004, a 35.1% increase over sales of \$53.5 million in 2003. The increase in direct sales was primarily due to increased sales into the United Kingdom, Germany, Canada, Italy and Spain, offset by decreased sales into France.

Our e-commerce sales decreased \$1.0 million to \$4.8 million in 2004, a 17.2% decrease over sales of \$5.8 million in 2003. Our e-commerce sales made up less than 1% of our consolidated net sales in both 2004 and 2003.

Gross profit

Gross profit for 2004 increased \$53.2 million to \$370.9 million as compared to \$317.7 million in 2003. Our domestic wholesale segment increased \$28.6 million, or 15.3%, to \$214.4 million in 2004 compared to \$185.8 million in 2003. Gross profit as a percentage of net sales, or gross margin, increased to 40.3% in 2004 from 38.0% in 2003. This gross margin increase was the result of the increase in domestic wholesale margins, which increased to 36.9% in

2004 from 33.0% for 2003, and as a result of retail sales becoming a larger portion of consolidated net sales, which achieve higher gross margins than our wholesale sales. The domestic wholesale

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margin increase was primarily due to the significantly lower volume of markdown merchandise, lower sales allowances and a lower volume of close-out product to discounters, all of which previously resulted from our significantly higher levels of inventory in 2003. In addition, we realized higher margins within our Men's and Women's Sport lines and Women's Active lines in 2004 compared to 2003.

Gross profit for our retail segment increased \$15.1 million, or 17.5%, to \$101.4 million in 2004 as compared to \$86.3 million in 2003. This increase in gross profit was due to 29 stores that were opened in 2003 being open the entire year in 2004 and positive comparable store sales. Gross margins decreased to 57.4% in 2004 as compared to 59.7% in 2003. The decrease in margin was primarily due to a larger portion of our retail sales coming from our lower margin outlet and warehouse stores, despite both positive comparable store sales increases and new store openings in these formats. In addition, we increased our promotional price activity within those store formats in 2004 when compared to 2003 which drove down our margins.

Gross profit for our international wholesale segment increased \$11.7 million, or 27.6%, to \$54.1 million for 2004 compared to \$42.4 million in 2003. Gross margins were 34.6% for 2004 compared to 34.9% in 2003. International wholesale sales through our foreign subsidiaries achieve higher gross margins than our international wholesale sales through our foreign distributors. Gross margins for our international subsidiary sales increased to 42.4% for 2004 compared to 41.6% in 2003. The increase in gross margins for our international subsidiary sales was due to a broader acceptance of our new styles as well as a lower volume of close-out product to discounters.

During the second half of 2004, our third-party manufacturers located in China notified us of electrical shortages which caused them, in some cases, to shut down production at least one day a week. For production orders that were outstanding with firm delivery dates and that did not ship in time to meet our delivery requirements, the manufacturer paid the costs to overnight product to our distribution centers. Future electrical shortages may extend the time necessary to produce our orders, and there may be circumstances where we may have to incur premium freight charges to expedite 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. We are currently unable to determine the extent, if any, of any adverse margin impact we may realize as a result of air freighting product to customers. Premium freight charges incurred during 2004 were not significant.

Licensing

Net licensing royalties increased \$2.9 million, or 69.0%, to \$7.1 million for 2004 compared to \$4.2 million in 2003. The increase in licensing royalties is primarily the result of an additional \$2.5 million in royalties associated with our licensing agreement for Skechers Kids apparel with Kids Headquarters, which launched during the back-to-school selling season in 2003. During 2003, we entered into various domestic and international licensing agreements. These new licensing arrangements have been in the development stage, and many of these licensed products became available at retail during 2004.

Selling expenses

Selling expenses decreased by \$5.0 million, or 5.9%, to \$79.7 million for 2004 from \$84.7 million in 2003. As a percentage of net sales, selling expenses were 8.7% and 10.1% in 2004 and 2003, respectively. The decrease in selling expenses was primarily due to reduced media advertising expenses of \$8.6 million, offset by increased trade show and catalog expenses of \$1.6 million and increased sales commissions and sales representative samples of \$2.0 million. Media advertising decreased due to a reduction in international advertising and promotional costs of approximately \$3.0 million despite commencing a major international print campaign in 2004 featuring international pop star Christina Aguilera, a reduction in television advertising of \$3.7 million and reduced promotional spending of \$1.9 million.

General and administrative expenses

General and administrative expenses increased by \$10.4 million, or 4.4%, to \$249.0 million for 2004 from \$238.6 million in 2003. As a percentage of sales, general and administrative expenses were 27.1% and 28.6% in 2004 and 2003, respectively. The increase in expenses was primarily the result of increased revenues in 2004. The increase in general and administrative expenses was primarily due to increased salaries and wages and related payroll costs of \$7.3 million, increased warehouse and distribution costs of \$2.6 million, increased rent of \$2.0 million and increased bad debt expense of \$2.1 million, which were partially offset by lower professional fees of \$3.9 million and travel

expenses of \$2.0 million. In addition, expenses related to our distribution network, including the functions of purchasing, receiving, inspecting, allocating, warehousing and packaging our products totaled \$71.3 million

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and \$62.4 million for 2004 and 2003, respectively. Impairment charges related to the write-off of fixed assets at one of our domestic retail stores was \$40,000 in 2004 as compared to \$0.6 million for the same period last year.

Interest income (expense)

Net interest expense for 2004 decreased \$0.8 million to \$8.0 million for 2004 compared to net interest expense of \$8.8 million in 2003. Interest expense is derived from our convertible notes, mortgages on our distribution center, our corporate office located in Manhattan Beach, California, our capital lease obligations and interest on amounts owed to our foreign manufacturers. The reduction in interest expense is due to the amortized reduction of our long-term debt and capital leases.

Other income (expense)

Other expense, net increased \$2.4 million to \$2.6 million for 2004, compared to \$0.2 million in year 2003. The increase in other expense was due the settlement of various lawsuits for \$2.3 million in 2004.

Income taxes

The effective tax rate for 2004 was 39.2%. Income tax expense for 2004 was \$15.2 million compared to \$1.5 million for 2003. The tax provision was computed using the effective tax rates applicable to each of our domestic and international taxable jurisdictions. The 2004 rate is 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 United States Internal Revenue Service. We have not provided for withholding and U.S. federal income taxes for our foreign undistributed earnings.

LIQUIDITY AND CAPITAL RESOURCES

Our working capital at December 31, 2005 was \$361.2 million, an increase of \$47.3 million from working capital of \$313.9 million at December 31, 2004. Our cash and cash equivalents at December 31, 2005 were \$197.0 million compared to \$137.7 million at December 31, 2004. The increase in cash and cash equivalents of \$61.1 million was the result of increased operating cash flows due to our net earnings of \$44.7 million in 2005, which included non-cash depreciation and amortization of \$23.4 million, as well as stock issuances of \$7.7 million, partially offset by capital spending of \$14.0 million and debt repayments of \$7.7 million.

During 2005, our operating activities generated \$75.9 million in net cash compared to cash provided by operating activities of \$33.0 million for 2004. The significant improvement in our operating cash flows for 2005, when compared to 2004, was the result of increased earnings and reduced inventory balances partially offset by increased accounts receivable balances. During the year, we successfully converted our Ontario distribution center into a foreign trade zone, which allows us to only pay import duties when goods are shipped. This has resulted in a reduction in our investment in inventory of approximately \$6.6 million as compared to December 31, 2004.

Net cash used in investing activities was \$14.0 million for 2005 as compared to \$16.0 million in 2004. The reduction in capital expenditures in 2005 was primarily due to the purchase of our corporate headquarters for \$11.0 million in the third quarter of 2004, offset by increased capital expenditures of \$7.0 million related to our opening of eleven retail stores and construction of a new corporate facility in 2005. 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. We expect the building to be completed by the end of 2007. Excluding the construction of our corporate headquarters we expect our on going capital expenditures for 2006 to be approximately \$12.0 million, which includes opening between 15 to 20 domestic retail stores and one international retail store, minor capital improvements at our distribution centers and investments in information technology. We do not anticipate entering any new international markets in 2006. We currently anticipate that our capital expenditure requirements will be funded through our operating cash flows or current cash on hand, or available lines of credit.

Net cash used by financing activities was \$0.7 million during 2005 compared to net cash provided by financing activities of \$5.9 million during 2004. The decrease in cash provided by financing activities was due to a balloon repayment of our long-term debt of \$4.6 million, and decreased cash provided from the issuance of stock, when compared to 2004.

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In April 2002, we issued \$90.0 million aggregate principal amount of 4.50% Convertible Subordinated Notes due April 15, 2007. Interest on the notes is paid semi-annually in April and October of each year. Discount and issuance costs of approximately \$3.4 million are being amortized to interest expense over the term of the debentures. The notes are convertible at the option of the holder into shares of Class A Common Stock at a conversion rate of 38.5089 shares of Class A Common Stock per \$1,000 principal amount of notes, which is equivalent to a conversion price of approximately \$25.968 per share. The conversion rate is subject to adjustment. The notes are subject to optional redemption at the option of our company, in whole or in part, at the following redemption prices: 101.80% of the principal amount for the twelve-month period beginning April 15, 2005, 100.90% of the principal amount for the twelve-month period beginning April 15, 2006 and 100% of the principal amount thereafter. The notes are unsecured and subordinated to our present and future senior debt as well as indebtedness and other liabilities of our subsidiaries. The indenture does not restrict our incurrence of indebtedness, including senior debt, or our subsidiaries' incurrence of indebtedness.

We have available a secured line of credit, amended as of June 25, 2004, permitting borrowings up to \$150.0 million based upon eligible accounts receivable and inventories. Borrowings bear interest at the prime rate (7.25% at December 31, 2005) minus 0.50%, and the agreement renews automatically from year to year unless terminated by either party upon written notice 60 days prior to year-end. The agreement provides for the issuance of letters of credit up to a maximum of \$30.0 million. Under the agreement, available borrowings are reduced by 50% of the first \$1 million of outstanding guarantees and 75% of outstanding guarantees that exceed \$1 million. Outstanding letters of credit at December 31, 2005 were \$3.9 million. Available borrowings under the line of credit at December 31, 2005 were \$147.4 million, and no amounts were outstanding at December 31, 2005. We pay an unused line of credit fee of 0.25% annually. The agreement provides the following financial covenants should the loan balance exceed 60% of all eligible accounts, as defined: stockholders' equity shall not decrease by more than 20% in any given calendar quarter; a tangible net worth be maintained as defined in the agreement; and limits to the payment of dividends if in default of any provision of the agreement. We were in compliance with these covenants at December 31, 2005.

We believe that anticipated cash flows from operations, available borrowings under our revolving line of credit, cash on hand, proceeds from the issuance of the notes and our financing arrangements will be sufficient to provide us with the liquidity necessary to fund our anticipated working capital and capital requirements through 2006. 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, 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. 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.

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DISCLOSURE ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The following table aggregates all material contractual obligations and commercial commitments as of December 31, 2005: