DECKERS OUTDOOR CORP
Form 10-Q
May 10, 2006

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

(Mark one)

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

For the quarterly period ended March 31, 2006

OR

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

For the transition period from __________ to __________

Commission File Number 0-22446

DECKERS OUTDOOR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	95-3015862
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
495-A South Fairview Avenue, Goleta, California	93117
(Address of principal executive offices)	(zip code)

(805) 967-7611

(Registrant s telephone number, including area code)

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

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.

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at May 4, 2006
Common Stock, $0.01 par value	12,516,624

DECKERS OUTDOOR CORPORATION
AND SUBSIDIARIES

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DECKERS OUTDOOR CORPORATION
AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

	March 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 10,552,000	$ 50,749,000
Short-term investments	54,788,000	2,500,000
Trade accounts receivable, less allowances for doubtful accounts, sales discounts and sales returns of $3,166,000 and $7,149,000 as of March 31, 2006 and December 31, 2005, respectively	28,193,000	40,918,000
Inventories	31,281,000	33,374,000
Prepaid expenses and other current assets	1,748,000	1,364,000
Deferred tax assets	5,949,000	5,949,000
Total current assets	132,511,000	134,854,000
Property and equipment, at cost, net	4,344,000	4,711,000
Intangible assets, net	69,932,000	70,009,000
Other assets	52,000	52,000
	$ 206,839,000	$ 209,626,000
Liabilities and Stockholders Equity		
Current liabilities:		
Trade accounts payable	$ 8,922,000	$ 14,506,000
Accrued expenses	4,918,000	6,095,000
Income taxes payable	4,179,000	7,133,000
Total current liabilities	18,019,000	27,734,000
Deferred tax liabilities	4,337,000	4,337,000
Stockholders equity:		
Common stock, $.01 par value. Authorized 20,000,000 shares; 12,487,584 shares issued and outstanding at March 31, 2006; 12,431,696 shares issued and outstanding at December 31, 2005	125,000	124,000
Additional paid-in capital	78,037,000	76,788,000
Retained earnings	106,085,000	100,436,000
Accumulated other comprehensive income	236,000	207,000
Total stockholders equity	184,483,000	177,555,000

	$ 206,839,000	$ 209,626,000

See accompanying notes to condensed consolidated financial statements.

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DECKERS OUTDOOR CORPORATION
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Condensed Consolidated Statements of Income
(Unaudited)

	Three-month period ended March 31, 2006	2005
Net sales	$ 56,004,000	$ 64,263,000
Cost of sales	31,304,000	34,696,000
Gross profit	24,700,000	29,567,000
Selling, general and administrative expenses	15,786,000	15,168,000
Income from operations	8,914,000	14,399,000
Other (income) expense:		
Interest income, net	(580,000)	(69,000)
Other		1,000
Income before income taxes	9,494,000	14,467,000
Income taxes	3,845,000	5,580,000
Net income	$ 5,649,000	$ 8,887,000
Net income per share:		
Basic	$ 0.45	$ 0.72
Diluted	0.44	0.69
Weighted-average common shares outstanding:		
Basic	12,468,000	12,285,000
Diluted	12,763,000	12,922,000

See accompanying notes to condensed consolidated financial statements.

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DECKERS OUTDOOR CORPORATION
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Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three-month period ended March 31,	
	2006	**2005**
Cash flows from operating activities:		
Net income	$ 5,649,000	$ 8,887,000
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	727,000	572,000
Provision for (recovery of) doubtful accounts	(427,000)	707,000
Write-down of inventories	1,331,000	696,000
Gain on sale of property and equipment	(5,000)	
Non-cash stock compensation	331,000	198,000
Tax benefits from stock-based compensation	95,000	
Changes in assets and liabilities:		
Trade accounts receivable	13,152,000	313,000
Inventories	762,000	(15,882,000)
Prepaid expenses and other current assets	(384,000)	235,000
Other assets		10,000
Trade accounts payable	(5,584,000)	(2,855,000)
Accrued expenses	(1,133,000)	(2,649,000)
Income taxes payable	(2,954,000)	1,808,000
Net cash provided by (used in) operating activities	11,560,000	(7,960,000)
Cash flows from investing activities:		
Purchases of property and equipment	(297,000)	(1,444,000)
Proceeds from sale of property and equipment	19,000	
Purchases of short-term investments	(63,766,000)	
Proceeds from sale of short-term investments	11,478,000	15,475,000
Net cash (used in) provided by investing activities	(52,566,000)	14,031,000
Cash flows from financing activities:		
Excess tax benefits from stock-based compensation	317,000	
Net cash received from issuances of common stock	507,000	1,161,000
Net cash provided by financing activities	824,000	1,161,000
Effect of exchange rates on cash	(15,000)	23,000

Net (decrease) increase in cash and cash equivalents	(40,197,000)	7,255,000
Cash and cash equivalents at beginning of period	50,749,000	10,379,000
Cash and cash equivalents at end of period	$ 10,552,000	$ 17,634,000
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Income taxes	$ 6,789,000	$ 3,771,000

See accompanying notes to condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements
(Unaudited)

(1) General

(a) Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual audited consolidated financial statements and, in the opinion of management, reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation for each of the periods presented. The results of operations for interim periods are not necessarily indicative of results to be achieved for full fiscal years. Our business is seasonal, with the highest percentage of Teva net sales occurring in the first and second quarters of each year and the highest percentage of UGG net sales occurring in the third and fourth quarters, while the quarter with the highest percentage of annual net sales for Simple has varied from year to year.

As contemplated by the Securities and Exchange Commission (SEC) under Rule 10-01 of Regulation S-X, the accompanying condensed consolidated financial statements and related footnotes have been condensed and do not contain certain information that will be included in the Company s annual consolidated financial statements and footnotes thereto. For further information, refer to the consolidated financial statements and related footnotes for the year ended December 31, 2005 included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

(b) Use of Estimates

The preparation of the Company s condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. Significant areas requiring the use of management estimates relate to inventory reserves, allowances for bad debts, returns and discounts, impairment assessments and charges, deferred taxes, depreciation and amortization, litigation reserves, fair value of share based payment, fair value of financial instruments, fair value of acquired intangibles, assets and liabilities. Actual results could differ from these estimates.

(2) Stock Compensation

On January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123R (SFAS 123R), Share-Based Payment to account for stock-based compensation. Prior to January 1, 2006, the Company accounted for stock-based compensation under the intrinsic value provisions of Accounting Principles Board, Opinion No. 25 (APB 25) Accounting for Stock Issued to Employees.

The Company has two stock based compensation plans. The Company s 1993 Stock Incentive Plan (the 1993 Plan) provides for 3,000,000 shares of common stock that are reserved for issuance to officers, directors, employees, and consultants of the Company. Awards to 1993 Plan participants are not restricted to any specified form and may include stock options, securities convertible into or redeemable for stock, stock appreciation rights, stock purchase warrants, or other rights to acquire stock. Stock option awards are generally granted with an exercise price equal to the market price of the Company s stock at the date of grant; those option awards generally vest on a graded basis over four years of continuous service and have ten-year contractual terms. The fair value of stock options is calculated using the Black-Scholes pricing model. No stock options were granted during the three months ended March 31, 2006 and 2005. New shares are expected to be issued for all awards.

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Beginning December 2004, the Company replaced its annual employee stock option grant with grants of nonvested stock units (NSU s). The NSU s granted pursuant to the 1993 Plan entitle the employee recipients to receive shares of common stock in the Company, which vest in quarterly increments between the third and fourth anniversary of the grant. Many of these awards include vesting that is also subject to achievement of certain performance targets.

In August 1995, the Company adopted the 1995 Employee Stock Purchase Plan (the 1995 Plan). The 1995 Plan is intended to qualify as an Employee Stock Purchase Plan under Section 423 of the Internal Revenue Code. Under the terms of the 1995 Plan, as amended, 300,000 shares of common stock are reserved for issuance to employees who have been employed by the Company for at least six months. The 1995 Plan provides for employees to purchase the Company s common stock at a discount below market value, as defined by the 1995 Plan. Under the 1995 Plan, 4,318 shares were issued in the first quarter of 2006. The 1995 Plan will terminate in September 2006, with the possibility of up to 4,318 shares being issued at that time. There will be no additional share issuances after that date.

Prior to January 1, 2006, in accordance with APB 25 the intrinsic value of the NSU s was recorded to compensation expense over the vesting period. Awards with performance conditions were accounted as variable with the intrinsic value remeasured at each reporting date. All NSU s are recorded as equity-based awards under SFAS 123R, whereby the fair value of the NSU is calculated based on the closing stock price on the grant date.

Additionally, on a quarterly basis the Company grants 400 fully-vested shares of its common stock to each of its outside directors. The fair value of such shares is expensed on the date of issuance.

As a result of our January 1, 2006 adoption of SFAS 123R, the impact to the condensed consolidated financial statements for the three months ended March 31, 2006 on income before taxes and on net income were reductions of $75,000 and $45,000, respectively. There was no impact on either basic or diluted earnings per share for the three months ended March 31, 2006. In addition, prior to the adoption of SFAS 123R, we presented the tax benefit of stock option exercises as operating cash flows. Upon the adoption of SFAS 123R, tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows.

The table below summarizes certain stock compensation amounts recognized in the three months ended March 31, 2006 and 2005:

	Three-month period ended March 31, 2006	2005
Compensation expense recorded for:		
NSU s	$ 313,000	132,000
Stock options	111,000	
1995 Plan	32,000	
Directors shares	64,000	66,000
Total compensation expense	520,000	198,000
Income tax benefit recognized in income statement	(212,000)	(76,000)

Net compensation expense	$ 308,000	122,000

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A summary of the activity under the 1993 Plan as of March 31, 2006, and changes during the period are presented below.

Summary Details for 1993 Plan Share Options

	Number of Shares	Weighted-Average Exercise Price ($)	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value ($)
Outstanding at January 1, 2006	628,200	7.16		
Granted				
Exercised	(49,600)	8.44		
Forfeited or expired	(20,100)	11.47		
Outstanding at March 31, 2006	558,500	6.89	5.01	18,794,000
Exercisable at March 31, 2006	438,500	5.77	4.45	15,248,000

During the three months ended March 31, 2006 and 2005, stock options exercised totaled 49,600 and 128,900, respectively, with a total intrinsic value of $962,000 and $4,397,000, respectively.

Nonvested Stock Units Issued Under the 1993 Plan

	Number of Shares	Weighted-Average Grant-Date Fair Value($)
Nonvested at January 1, 2006	155,800	30.76
Granted	14,500	35.50
Vested		
Forfeited	(12,500)	30.79
Nonvested at March 31, 2006	157,800	31.20

As of March 31, 2006, there was $4,757,000 of total unrecognized compensation cost related to stock options and NSU s that will vest in the future is over a weighted-average vesting period of 3.4 years. Tax benefit realized from stock options exercised during the three months ended March 31, 2006 and 2005 was $412,000 and $1,796,000, respectively.

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

Pro forma information regarding the effect on the net income and basic and diluted income per share for the three months ended March 31, 2005, had we applied the fair value recognition provisions of SFAS No. 123, is as follows:

		Three-month period ended March 31, 2005
Net income as reported	$	8,887,000
Add stock-based employee compensation expense included in reported net income, net of tax effect		122,000
Deduct total stock-based employee compensation expense under fair value-based method for all awards, net of tax		(241,000)
Pro forma net income	$	8,768,000
Net income per share:		
Basic as reported	$	0.72
Basic pro forma		0.71
Diluted as reported		0.69
Diluted pro forma		0.68

(3) Comprehensive Income

Comprehensive income is the total of net income and all other nonowner changes in equity. At March 31, 2006 and December 31, 2005, accumulated other comprehensive income of $236,000 and $207,000, respectively, consisted entirely of cumulative foreign currency translation adjustment. The Company does not have any other transactions or other economic events that qualify as comprehensive income.

Comprehensive income is determined as follows:

	Three-month period ended March 31,		
		2006	2005
Net income	$	5,649,000	8,887,000
Cumulative foreign currency translation adjustment		29,000	(37,000)
Total comprehensive income	$	5,678,000	8,850,000

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Notes to Condensed Consolidated Financial Statements (Unaudited)

(4) Income per Share

Basic income per share represents net income divided by the weighted-average number of common shares outstanding for the period. Diluted income per share represents net income divided by the weighted-average number of shares outstanding, including the dilutive impact of potential issuances of common stock. For the three-month periods ended March 31, 2006 and 2005, the difference between the weighted-average number of shares used in the basic computation and that used in the diluted computation resulted from the dilutive impact of options to purchase common stock.

The reconciliations of basic to diluted weighted-average common shares outstanding are as follows for the three-month periods ended March 31, 2006 and 2005:

	Three-month period ended March 31,	
	2006	**2005**
Weighted-average shares used in basic computation	12,468,000	12,285,000
Dilutive impact of stock options	295,000	637,000
Weighted-average shares used for diluted computation	12,763,000	12,922,000

All options outstanding as of March 31, 2006 and 2005 were included in the computation of diluted income per share for the three-month periods ended March 31, 2006 and 2005.

The Company excluded 72,400 and 59,750 contingently issuable shares of common stock underlying its nonvested stock units from the diluted income per share computations for the three-month periods ended March 31, 2006 and 2005, respectively. The shares were excluded because the necessary conditions had not been satisfied for any shares to be issuable based on the Company s performance through March 31, 2006 and 2005, respectively.

(5) Credit Facility

The Company s revolving credit facility with Comerica Bank (the Facility) provides for a maximum availability of $20,000,000, subject to a borrowing base. In general, the borrowing base is equal to 75% of eligible accounts receivable and 50% of eligible inventory, each as defined in the Facility agreement. Up to $10,000,000 of borrowings may be in the form of letters of credit. The Facility bears interest at the lender s prime rate (7.75% at March 31, 2006) or, at our option, at LIBOR (4.83% at March 31, 2006) plus 1.0% to 2.5%, depending on our ratio of liabilities to earnings before interest, taxes, depreciation and amortization, and is secured by substantially all of our assets. The Facility includes annual commitment fees of $60,000 per year and expires on June 1, 2007. At March 31, 2006, the Company had no outstanding borrowings under the Facility, no foreign currency reserves for outstanding forward contracts and outstanding letters of credit of $52,000. As a result, $19,948,000 was available under the Facility at March 31, 2006.

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(6) Income Taxes

Income taxes for the interim periods were computed using the effective tax rate estimated to be applicable for the full fiscal year, which is subject to ongoing review and evaluation by management. For the three months ended March 31, 2006, the Company recorded an income tax expense of $3,845,000, representing an effective income tax rate of 40.5%. For the three months ended March 31, 2005, the Company recorded an income tax expense of $5,580,000, representing an effective income tax rate of 38.6%.

(7) Recent Accounting Pronouncements

The Company adopted SFAS 123R on January 1, 2006. The impact of the adoption is discussed in note 2 above.

In November 2004, the FASB issued Statement of Financial Accounting Standards, or SFAS No. 151, Inventory Costs An Amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4 . SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing , to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS No. 151 is effective for fiscal years beginning after June 15, 2005 and was adopted on January 1, 2006. The adoption of this Statement did not have a material effect on our condensed consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of Accounting Principles Board Opinion (APB) No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. This Statement requires retrospective application to prior periods financial statements of a change in accounting principle. It applies both to voluntary changes and to changes required by an accounting pronouncement if the pronouncement does not include specific transition provisions. APB 20 previously required that most voluntary changes in accounting principles be recognized by recording the cumulative effect of a change in accounting principle. SFAS 154 is effective for fiscal years beginning after December 15, 2005. The Company adopted this statement on January 1, 2006, and it did not have a material effect on the financial statements upon adoption.

(8) Business Segments

The Company s accounting policies of the segments below are the same as those described in the summary of significant accounting policies, except that the Company does not allocate interest, income taxes, or unusual items to segments. The Company evaluates performance based on net sales and profit or loss from operations. The Company s reportable segments include the strategic business units responsible for the worldwide operations of each of its brands and its Consumer Direct business. They are managed separately because each business requires different marketing, research and development, design, sourcing and sales strategies. The earnings from operations for each of the segments includes only those costs which are specifically related to each segment, which consist primarily of cost of sales, costs for research and development, design, marketing, sales, commissions, royalties, bad debts, depreciation, amortization and the costs of employees directly related to each business segment. The unallocated corporate overhead costs are the shared costs of the organization and include, among others, the following costs: costs of the distribution center, information technology, human resources, accounting and finance, credit and collections, executive compensation and facilities costs. The operating income derived from the sales to third parties of the Consumer Direct segment is separated into two components: (i) the wholesale profit is included in the operating income of each of the three brands, and (ii) the retail profit is included in the operating income of the Consumer Direct segment.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

Net sales and operating income (loss) by business segment for the three months ended March 31, 2006 and 2005 are summarized as follows:

	Three months ended March 31, 2006	Three months ended March 31, 2005
Net sales to external customers:		
Teva wholesale	$ 33,826,000	38,421,000
UGG wholesale	12,428,000	18,754,000
Simple wholesale	3,217,000	2,123,000
Consumer Direct	6,533,000	4,965,000
	$ 56,004,000	64,263,000

	Three months ended March 31, 2006	Three months ended March 31, 2005
Income (loss) from operations:		
Teva wholesale	$ 10,426,000	13,357,000
UGG wholesale	4,131,000	5,881,000
Simple wholesale	(68,000)	203,000
Consumer Direct	2,197,000	1,167,000
Unallocated overhead costs	(7,772,000)	(6,209,000)
	$ 8,914,000	14,399,000

Business segment asset information as of March 31, 2006 and December 31, 2005 is summarized as follows:

	March 31, 2006	December 31, 2005
Total assets for reportable segments:		
Teva wholesale	$ 96,861,000	83,901,000
UGG wholesale	27,278,000	56,907,000
Simple wholesale	6,035,000	5,211,000
Consumer Direct	697,000	945,000
	$ 130,871,000	146,964,000

The assets allocable to each reporting segment generally include accounts receivable, inventories, intangible assets, and certain other assets that are specifically identifiable with one of the Company s business segments. Unallocated corporate assets are the assets not specifically related to one of the segments and generally include the Company s cash and cash equivalents, short-term investments, refundable and deferred tax assets and various other assets shared by the Company s segments.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

Reconciliations of total assets from reportable segments to the condensed consolidated balance sheets at March 31, 2006 and December 31, 2005 are as follows:

	March 31, 2006	December 31, 2005
Total assets for reportable segments	$ 130,871,000	146,964,000
Unallocated deferred tax assets	5,949,000	5,949,000
Other unallocated corporate assets	70,019,000	56,713,000
Consolidated total assets	$ 206,839,000	209,626,000

(9) Contingencies

The Company is currently involved in various legal claims arising from the ordinary course of its business. Management does not believe that the disposition of these matters will have a material effect on the Company s consolidated financial position or results of operations.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

The matters discussed in Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report that are not historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We sometimes use words such as anticipate, believe, continue, estimate, expect, intend, may, project, will expressions, as they relate to us, our management and our industry, to identify forward-looking statements. Forward-looking statements relate to our expectations, beliefs, plans, strategies, prospects, future performance, anticipated trends and other future events. Specifically, this report and the information incorporated by reference in this report contain forward-looking statements relating to, among other things:

- our business, growth, operating and financing strategies;
- our product mix;
- the success of new products;
- our licensing strategy;
- the impact of seasonality on our operations;
- expectations regarding our net sales and earnings growth;
- expectations regarding our liquidity;
- our future financing plans; and
- trends affecting our financial condition or results of operations.

We have based our forward-looking statements largely on our current expectations and projections about future events and financial trends affecting our business. Actual results may differ materially. Some of the risks, uncertainties and assumptions that may cause actual results to differ from these forward-looking statements are described in Risk Factors. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report and the information incorporated by reference in this report might not happen.

You should completely read this report, the documents that we filed as exhibits to this report and the documents that we incorporate by reference in this report with the understanding that our future results may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements and we assume no obligation to update such forward-looking statements publicly for any reason.

The Deckers, UGG, Teva, and Simple families of related marks, images and symbols are our trademarks and intellectual property. Other trademarks, trade names and service marks appearing in this report are the property of their respective holders. References to Deckers, we, us, our, or similar terms refer to Deckers Outdoor Corporation together with its consolidated subsidiaries.

Overview

We are a leading designer, producer and brand manager of innovative high-quality footwear and the category creator in the sport sandal and luxury sheepskin footwear segments. We market our products under three proprietary brands:

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- Teva: High performance sport sandals and rugged outdoor footwear;
- UGG: Authentic luxury sheepskin boots and a full line of luxury and comfort footwear; and
- Simple: Innovative shoes that combine the comfort elements of athletic footwear with casual styling.

We sell our three brands through our quality domestic retailers and international distributors and directly to our end-user consumers through our Consumer Direct business. We sell our footwear in both the domestic market and the international markets. Independent third parties manufacture all of our footwear.

Our business has been impacted by several important trends affecting our end markets:

- The markets for casual, outdoor and athletic footwear have grown significantly during the last decade. We believe this growth is a result of the trend toward casual dress in the workplace, increasingly active outdoor lifestyles and a growing emphasis on comfort.
- Consumers are more often seeking footwear designed to address a broader array of activities with the same quality, comfort and high performance attributes they have come to expect from traditional athletic footwear.
- Our customers have narrowed their footwear product breadth, focusing on brands with a rich heritage and authenticity as market creators and leaders.
- Consumers have become increasingly focused on luxury and comfort, seeking out products and brands that are fashionable while still comfortable.

By emphasizing our brand image and our focus on comfort, performance and authenticity, we believe we can better maintain a loyal consumer following that is less susceptible to fluctuations caused by changing fashions and changes in consumer preferences.

Set forth below is an overview of the various components of our business, including some of the important factors that affect each business and some of our strategies for growing each business.

Teva Overview

We initially produced Teva products under a license from the inventor of the Teva technology, Mark Thatcher. In November 2002, we purchased from Mr. Thatcher the Teva worldwide assets, including the Teva Internet and catalog business and all patents, trade names, trademarks and other intellectual property associated with the acquired Teva assets, or the Teva Rights. As a result of our purchase of the Teva Rights, we have adopted a strategy to expand the Teva brand and more fully develop its potential.

From fiscal 2001 to 2004, Teva s wholesale net sales increased at a compound annual growth rate of 10.9%. However, for the fiscal year 2005 and the first quarter of 2006, Teva wholesale net sales decreased by approximately 3.6% and 12.0%, respectively, compared to the year ago periods. The recent decline has been due to several factors including an unseasonably cold Spring 2005 and wet Spring 2006 seasons, increased competition, a recent lack of meaningful product innovation, and a decline in sales in the European market. We are proactively addressing the situation going forward by dedicating significantly greater resources to product development, marketing and advertising and the development of a solid international infrastructure. However, given the lead times required for these projects to yield results, we do not expect growth for Teva in 2006, but expect to return to growth for Teva beginning with the Spring 2007 season.

Despite the recent downturn, we believe that over the last few years Teva s products have benefited from several factors, but most prominently a general shift in consumer preferences and lifestyles to include more

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outdoor recreational activities. At the same time, our consumers are increasingly purchasing our Teva products for everyday wear, and our Teva brand now includes several closed-toe footwear lines. As a result, our brand remains popular among professional and amateur outdoorsmen seeking authentic, performance-oriented footwear, as well as general footwear consumers seeking high quality, durable and comfortable styles for everyday use.

To capitalize on the growth of outdoor recreational activities and the acceptance of certain footwear products for everyday use, over the last few years we have selectively expanded the distribution of our Teva product lines outside our core outdoor specialty and sporting goods channels. Through effective channel management, we believe we can continue to expand into new distribution channels without diluting our outdoor heritage and our appeal to outdoor enthusiasts. Through appropriate channel product line expansion, we plan to continue to broaden our product offerings beyond sport sandals to new products that meet the style and functional needs of our consumers.

UGG Overview

UGG has been a well-known brand in California for many years and over the past few years has become a recognized brand throughout the remainder of the country. Since early 2003, our UGG brand has received increased media exposure, which contributed to broader public awareness of the UGG brand and significantly increased demand for the collection. We believe that the increased media focus on UGG was driven by the product s unique styling and resulting brand name identification, Australian heritage and adoption by high-profile film and television celebrities as a favored footwear brand. We believe this increased media attention has enabled us to introduce the brand to consumers much faster than we would have ordinarily been able to. We believe that a portion of UGG s increased demand is due to our continued geographical expansion across the U.S.

In addition, we have recently begun to expand our distribution and marketing overseas in order to address the under-penetrated international markets. Net sales of UGG in the international markets aggregated $971,000 in 2003, $13,297,000 in 2004 and $12,332,000 in 2005. Despite the slight decline in 2005, we believe that with our strategy to develop an international infrastructure, the international markets represent an attractive opportunity to grow UGG s sales over the next few years.

We believe the fundamental comfort and functionality of UGG products will continue to drive long-term consumer demand. Recognizing that there is a significant fashion element to UGG and that footwear fashions fluctuate, our strategy seeks to prolong the longevity of the brand by offering a broader product line suitable for wear in a variety of climates and occasions and by limiting distribution to selected higher-end retailers. As part of this strategy, we have expanded our product line to 125 models in 2006 from 52 models in 2002. This product line expansion includes our significantly expanded Spring and Fall 2006 Fashion Collection and Men s offering, as well as new styles in our Driving Collection, our newly introduced Surf Collection, our Cold Weather Collection and our luxury slipper category. Nevertheless, we cannot assure investors that UGG sales will continue to grow at their recent pace or that revenue from UGG products will not at some point decline.

Four suppliers currently provide all of the sheepskin, the principal raw material for our UGG products, purchased by our independent manufacturers. Our potential inability to obtain top quality sheepskin for UGG products could impair our ability to meet our production requirements for UGG products in a timely manner and could lead to inventory shortages, which can result in lost potential sales, delays in shipments to customers, strain on our relationships with customers and diminished brand loyalty. There have also been significant increases in the prices of footwear quality sheepskin as the demand for this material has increased. Any further price increases will likely raise our costs, increase our costs of sales and decrease our profitability unless we are able to pass higher prices on to

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our customers. We believe the demand for this material may continue to outpace supply in the future, leading to possible shortages and our inability to produce as much of certain styles as our customers would like to order.

Simple Overview

In 2005, the Simple product line focused on rebuilding its core product segments, sneakers and clogs, and in the later part of the year, introduced new styles and categories of footwear including women s leather sandal package, men s and women s flip flops, and the Green Toe Collection of 100% natural, ecologically-friendly footwear, which has been well received by retailers and the media. At the same time, we have changed our sales and distribution efforts through increased marketing efforts as well as improvements in distribution through the establishment of separate dedicated sales representatives for the Simple brand in several territories. These efforts resulted in an increase of Simple s wholesale net sales of 51.5% in the first quarter of 2006 compared to the same period in 2005. We expect our Simple brand to experience growth as we continue to develop our re-focused product line and successfully implement our strategy to expand our distribution channels for the Simple brand.

Consumer Direct Overview

Our Consumer Direct business includes our Internet and catalog retailing operations as well as our retail outlet stores. We acquired our Internet and catalog retailing business in November 2002 as part of the acquisition of the Teva Rights. In 2005, we also opened a retail outlet store in a premium retail outlet mall in Camarillo, California in addition to our other retail outlet store at the Ventura, California distribution center. Based on the success of the existing stores, we currently expect to open additional retail outlet stores in select premium outlet malls in the U.S. and an additional concept store in a major metropolitan city in 2006. Our Consumer Direct business, which today sells all three of our brands, enables us to meet the growing demand for these products, sell the products at retail prices and provide us with significant incremental operating income. From the time we initiated our Consumer Direct business through the first quarter of 2006, we have had significant revenue growth, much of which occurred as the underlying brands gained popularity, as consumers have continued to increase reliance on the Internet for footwear and other purchases and as we began to open retail outlet stores. Net sales of the Consumer Direct business were $6,533,000 in the three months ended March 31, 2006 compared to $4,965,000 for the three months ended March 31, 2005.

Managing our Internet business requires us to focus on generating Internet traffic to our websites, to effectively convert website visits into orders and to maximize average order sizes. We distribute approximately 400,000 catalogs every six months to drive our catalog order business. Overall, our Consumer Direct business benefits from the strength of our brands and, as we grow our brands over time, we expect this business to continue to be an important segment of our business.

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Licensing Overview

In 2004, we embarked on a strategy to license our footwear brands to complementary products outside of footwear, generally in the apparel and accessories categories. We currently have nine licensing agreements with six licensees for Teva and UGG combined. We recently terminated three of our domestic licensing agreements. We have only recently begun to recognize licensing revenues and we do not expect significant incremental net sales and profits from licensing in the near future. For the three months ended March 31, 2006, we recognized net license revenues of $14,000, primarily related to our UGG handbag license, compared to $201,000 for the three months ended March 31, 2005. The minimum net annual royalties that we are scheduled to receive under the remaining existing licensing agreements, assuming renewal options are exercised, are $505,000 in 2006, $571,000 in 2007, $591,000 in 2008, $596,000 in 2009 and $610,000 in 2010. The activity is very small in relation to the consolidated operations and, therefore, separate segment information is not presented.

Seasonality

Our business is seasonal, with the highest percentage of Teva net sales occurring in the first and second quarters of each year and the highest percentage of UGG net sales occurring in the third and fourth quarters. To date, Simple has not had a seasonal impact on the Company.

	2006
	First Quarter
Net sales	$56,004,000
Income from operations	$ 8,914,000

	2005			
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Net sales	$64,263,000	$40,341,000	$69,193,000	$90,963,000
Income from operations	$14,399,000	$ 4,677,000	$14,018,000	$19,174,000

	2004			
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Net sales	$44,272,000	$40,546,000	$55,797,000	$74,172,000
Income from operations	$ 9,628,000	$ 9,274,000	$ 9,358,000	$14,202,000

Given our expectations for each of our brands in 2006, we currently expect this trend to continue. Nonetheless, actual results could differ materially depending upon consumer preferences, whether the UGG brand will continue to grow at the rate it has experienced in the recent past, availability of product, competition and our customers continuing to carry and promote our various product lines, among other risks and uncertainties. See Risk Factors.

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Results of Operations

The following table sets forth certain operating data for the periods indicated.

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Net sales by location:		
U.S.	$ 43,656,000	$ 49,163,000
International	12,348,000	15,100,000
Total	$ 56,004,000	$ 64,263,000
Net sales by product line and Consumer Direct business:		
Teva:		
Wholesale	$ 33,826,000	$ 38,421,000
Consumer Direct	851,000	963,000
Total	34,677,000	39,384,000
UGG:		
Wholesale	12,428,000	18,754,000
Consumer Direct	5,357,000	3,758,000
Total	17,785,000	22,512,000
Simple:		
Wholesale	3,217,000	2,123,000
Consumer Direct	325,000	244,000
Total	3,542,000	2,367,000
Total	$ 56,004,000	$ 64,263,000

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Income (loss) from operations by product line and Consumer Direct business:		
Teva wholesale	$ 10,426,000	$ 13,357,000
UGG wholesale	4,131,000	5,881,000
Simple wholesale	(68,000)	203,000
Consumer Direct	2,197,000	1,167,000
Unallocated overhead costs	(7,772,000)	(6,209,000)

Total	$ 8,914,000	$ 14,399,000

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The following table sets forth certain operating data as a percentage of net sales for the periods indicated, and the increase (decrease) in each item of operating data between the periods.

	Three Months Ended March 31,		Percent Increase 2006 to
	2006	2005	2005
Net sales	100.0%	100.0%	(12.9)%
Cost of sales	55.9	54.0	(9.8)
Gross profit	44.1	46.0	(16.5)
Selling, general and administrative expenses	28.2	23.6	4.1
Income from operations	15.9	22.4	(38.1)
Other income, net	(1.0)	(0.1)	*
Income before income taxes	17.0	22.5	(34.4)
Income taxes	6.9	8.7	(31.1)
Net income	10.1%	13.8%	(36.4)%

* Calculation of percentage change is not meaningful.

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2005

Overview. For the three months ended March 31, 2006, we had net sales of $56,004,000 and income from operations of $8,914,000 compared to net sales of $64,263,000 and income from operations of $14,399,000 for the three months ended March 31, 2005. These results were primarily due to a decrease in UGG and Teva sales, partially offset by an increase in Simple sales. Income from operations decreased as a result of the decrease in sales, a gross margin decline and an increase in selling, general and administrative expenses.

Net Sales. Net sales decreased by $8,259,000, or 12.9%, to $56,004,000 for the three months ended March 31, 2006 from $64,263,000 for the three months ended March 31, 2005. Net sales decreased for the three months ended March 31, 2006 due primarily to the reduction of UGG and Teva sales, partially offset by higher Simple sales, as discussed below. In addition, the Company s weighted-average wholesale selling price per unit decreased 12.9% to $18.49 for the three months ended March 31, 2006 from $21.23 for the three months ended March 31, 2005, resulting primarily from lower UGG sales and higher closeout sales. During the quarter, the Company experienced a decrease in the number of units sold of Teva and UGG, partially offset by an increase in the number of units sold of Simple, resulting in a 2.6% overall decrease in the volume of footwear sold to 2,749,000 pairs for the three months ended March 31, 2006 from 2,822,000 pairs for the three months ended March 31, 2005.

Net wholesale sales of Teva decreased by $4,595,000, or 12.0%, to $33,826,000 for the three months ended March 31, 2006 from $38,421,000 for the three months ended March 31, 2005 due to an unseasonably wet Spring 2006 season, increased competition, a recent lack of meaningful product innovation, and a decline in sales in the European market. See Overview Teva Overview above.

Net wholesale sales of UGG decreased by $6,326,000, or 33.7%, to $12,428,000 for the three months ended March 31, 2006 from $18,754,000 for the three months ended March 31, 2005, due primarily to approximately

$10,000,000 of Fall 2004 holiday sales that did not ship until the first quarter of 2005; Fall 2005 holiday products were shipped on time since the Company brought in inventory much earlier in 2005 than it did in 2004

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in order to ensure more timely deliveries to customers. The decline was partially offset with sales of the brand s inaugural spring line. See Overview UGG Overview above.

Net wholesale sales of Simple increased by $1,094,000, or 51.5%, to $3,217,000 for the three months ended March 31, 2006 from $2,123,000 for the three months ended March 31, 2005. This increase was largely due to the introduction of the Sandal and Green Toe Collections. See Overview Simple Overview above.

Net sales of the Consumer Direct business increased by $1,568,000, or 31.6%, to $6,533,000 for the three months ended March 31, 2006 from $4,965,000 for the three months ended March 31, 2005. For the three months ended March 31, 2006, net sales of the Consumer Direct business included retail sales of Teva of $851,000 UGG of $5,357,000 and Simple of $325,000. For the three months ended March 31, 2005, the breakdown consisted of sales of Teva of $963,000, UGG of $3,758,000 and Simple of $244,000. The increase in net sales of the Consumer Direct business occurred due to the greater demand for UGG products and the additional sales of our retail outlet store, which was not in place in the same period in 2005. See Overview Consumer Direct Overview above.

International sales for all of our products decreased by $2,752,000, or 18.2%, to $12,348,000 for the three months ended March 31, 2006 from $15,100,000 for the three months ended March 31, 2005, representing 22.0% of net sales for the three months ended March 31, 2006 and 23.5% of net sales for the three months ended March 31, 2005. The decrease in international sales resulted from decreased sales of Teva and UGG product, partially offset by an increase in Simple international sales.

Gross Profit. Gross profit decreased by $4,867,000, or 16.5%, to $24,700,000 for the three months ended March 31, 2006, from $29,567,000 for the three months ended March 31, 2005. As a percentage of net sales, gross margin was 44.1% for the three months ended March 31, 2006, compared to 46.0% for the three months ended March 31, 2005, primarily due to an increased impact of closeout sales and inventory write-downs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses, or SG&A, increased by $618,000, or 4.1%, to $15,786,000 for the three months ended March 31, 2006 from $15,168,000 for the three months ended March 31, 2005. As a percentage of net sales, SG&A increased to 28.2% for the three months ended March 31, 2006 from 23.6% for the three months ended March 31, 2005. The increase in SG&A expenses was largely due to an increase in marketing, payroll and warehouse costs, partially offset by lower bad debt and commission expense on the lower sales levels.

Income from Operations. Income from operations decreased by $5,485,000, or 38.1%, to $8,914,000 in the three-month period ended March 31, 2006 from $14,399,000 in the three-month period ended March 31, 2005. This was due primarily to the decrease in gross profit on reduced sales as well as the increase in SG&A expenses.

Income from operations of Teva wholesale decreased by $2,931,000, or 21.9%, to $10,426,000 for the three months ended March 31, 2006 from $13,357,000 for the three months ended March 31, 2005. This decrease was largely due to the $4,595,000 decrease in net sales and a decrease in gross margin due to an increased impact of closeout sales, as well as the increase in marketing, research and development costs and bad debt expense. This was partially offset by lower selling commissions related to the lower sales volume.

Income from operations of UGG wholesale decreased by $1,750,000, or 29.8%, to $4,131,000 for the three months ended March 31, 2006, from $5,881,000 for the three months ended March 31, 2005. The decrease was primarily the result of the lower sales volume from the 2004 carryover in the first quarter of 2005 and increased marketing expenses, partially offset by a decrease in bad debt expense and selling commissions on the lower sales volume.

Loss from operations of Simple wholesale was $68,000 for the three months ended March 31, 2006 compared to income from operations of $203,000 for the three months ended March 31, 2005. In spite of achieving higher net sales for the first quarter of 2006, Simple experienced lower gross margins from increased closeout sales and inventory write-downs along with higher operating costs, which resulted in a loss from operations for the current reporting period.

Income from operations of our Consumer Direct business increased by $1,030,000, or 88.3%, to $2,197,000 for the three months ended March 31, 2006, from $1,167,000 for the three months ended March 31, 2005. This was largely due to the increase in net sales of $1,568,000, partially offset by higher operating costs.

Unallocated overhead costs increased by $1,563,000 or 25.2%, to $7,772,000 for the three months ended March 31, 2006 from $6,209,000 for the three months ended March 31, 2005, resulting primarily from higher warehouse and international division costs, which are not allocated to the brands, as well as higher corporate payroll costs.

Other (Income) Expense. Net interest income was $580,000 for the three months ended March 31, 2006, compared with net interest income of $69,000 for the three months ended March 31, 2005. The interest income in 2005 resulted primarily from the investment of our higher cash balances as well as higher return rates in the current year compared to the same period a year ago. Other (income) expense exclusive of net interest income was not material in either period.

Income Taxes. For the three months ended March 31, 2006, income tax expense was $3,845,000, representing an effective income tax rate of 40.5%. For the three months ended March 31, 2005, income tax expense was $5,580,000 representing an effective income tax rate of 38.6%. The increase in the effective tax rate was primarily due to a higher projected annual pre-tax income for our domestic operating unit, which bears a higher tax rate than that of our international subsidiaries, resulting in a higher blended effective tax rate for the current year. The effective tax rate is subject to ongoing review and evaluation by management and can change from quarter to quarter.

Net Income. Our net income decreased 36.4% to $5,649,000 from $8,887,000 as a result of the items discussed above. Our earnings per diluted share decreased 36.2% to $0.44 from $0.69, primarily as a result of the decrease in net income.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements other than operating leases. See Contractual Obligations below. We do not believe that these operating leases are material to our current or future financial condition, results of operations, liquidity, capital resources or capital expenditures.

Liquidity and Capital Resources

We finance our working capital and operating needs using a combination of our cash and cash equivalents balances, short-term investments, cash generated from operations and the credit availability under our revolving credit facility. The seasonality of our business requires us to build inventory levels in anticipation of the sales for the coming season. Teva generally begins to build inventory levels beginning in the fourth quarter and first quarter in anticipation of the Spring selling season that occurs in the first and second quarters, whereas UGG generally builds its inventories in the second quarter and third quarter to support sales for the Fall and Winter selling seasons, which historically occur during the third and fourth quarters.

Our cash flow cycle includes the purchase of these inventories, the subsequent sale of the inventories and the eventual collection of the resulting accounts receivable. As a result, our working capital requirements begin when we purchase the inventories and continue until we ultimately collect the resulting receivables. Given the seasonality of our Teva and UGG brands, our working capital requirements fluctuate significantly throughout

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the year. The cash required to fund these working capital fluctuations is generally provided using a combination of our internal cash flows and borrowings under our revolving credit facility.

Cash from Operating Activities. Net cash provided by operating activities was $11,560,000 for the three months ended March 31, 2006 compared to net cash used in operating activities of $7,960,000 for the three months ended March 31, 2005. The change in net cash from operating activities for the three months ended March 31, 2006 compared to the three months ended March 31, 2005 was primarily due to a decrease in receivables and inventories in 2006 compared to a significant increase in inventory in 2005, partially offset by a decrease in net earnings and a pay down of accounts payable and accrued expenses during the period. Net working capital improved by $7,129,000 to $114,249,000 as of March 31, 2006 from $107,120,000 as of December 31, 2005, primarily as a result of net income for the period of $5,649,000.

Cash from Investing Activities. For the three months ended March 31, 2006, net cash used in investing activities was $52,566,000, which was comprised primarily of the net purchases of short-term investments held by the Company at March 31, 2006. In addition, the Company used $297,000 for capital expenditures, primarily related to the replacement and upgrading of certain computer equipment. For the three months ended March 31, 2005, net cash provided by investing activities was $14,031,000, which was comprised primarily of the sale of short-term investments held by the Company at December 31, 2004.

Cash from Financing Activities. For the three months ended March 31, 2006, net cash provided by financing activities was $824,000 compared to net cash provided by financing activities of $1,161,000 for the three months ended March 31, 2005. For the three months ended March 31, 2006, the net cash provided by financing activities consisted primarily of cash received from the exercise of stock options as well as the tax benefit attributable to stock options. For the three months ended March 31, 2005, net cash provided by financing activities was made up entirely from cash received from the exercise of stock options.

Our liquidity consists primarily of cash, short-term investments, trade accounts receivable, inventories and a revolving credit facility. At March 31, 2006, working capital was $114,249,000 including $10,552,000 of cash and cash equivalents and $54,788,000 of short-term investments. Cash provided by operating activities aggregated $11,560,000 for the three months ended March 31, 2006. Trade accounts receivable decreased by 31.1% to $28,193,000 at March 31, 2006 from $40,918,000 at December 31, 2005, largely due to normal seasonality. Accounts receivable turnover increased to 7.2 times in the twelve months ended March 31, 2006 from 6.9 times in the twelve months ended December 31, 2005.

Inventories decreased by 6.3% to $31,281,000 at March 31, 2006 from $33,374,000 at December 31, 2005, reflecting a $2,054,000 decrease in UGG inventory, a $681,000 decrease in Simple inventory, and a $643,000 increase in Teva inventory. Overall, inventory turnover decreased slightly to 3.1 times for the twelve months ended March 31, 2006 from 3.2 times for the twelve months ended December 31, 2005 due in part to lower sales levels during the twelve months ended March 31, 2006 and partially offset by lower average inventory levels during that same period. The $2,054,000 decrease in UGG inventory at March 31, 2006 was due to normal seasonality as well as the high sell-through of UGG products in the three months ended March 31, 2006. The $681,000 decrease in Simple inventory at March 31, 2006, compared to December 31, 2005, was largely due to increased sales in the first quarter of 2006. The $643,000 increase in Teva inventory occurred largely due to seasonality.

Our revolving credit facility with Comerica Bank (the Facility) provides for a maximum availability of $20,000,000, subject to a borrowing base. In general, the borrowing base is equal to 75% of eligible accounts receivable and 50% of eligible inventory, each as defined in the Facility agreement. Up to $10,000,000 of borrowings may be in the form of letters of credit. The Facility bears interest at the lender s prime rate (7.75% at March 31, 2006) or, at our option, at LIBOR (4.83% at March 31, 2006) plus 1.0% to 2.5%, depending on our ratio of liabilities to earnings before interest, taxes, depreciation and amortization, and is secured by substantially all of our assets. The Facility includes annual commitment fees of $60,000 per year and expires on June 1, 2007. At March 31, 2006, we had no outstanding borrowings under the Facility, no foreign currency reserves for

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outstanding forward contracts and outstanding letters of credit of $52,000. As a result, $19,948,000 was available under the Facility at March 31, 2006.

The agreements underlying the Facility contain several financial covenants including a quick ratio requirement, profitability requirements and a tangible net worth requirement, among others, as well as a prohibition on the payment of dividends. We were in compliance with all covenants at March 31, 2006, and remain so as of the date of this report.

Capital expenditures totaled $297,000 for the three months ended March 31, 2006, and related primarily to the replacement and upgrading of certain computer equipment. We currently have no material commitments for future capital expenditures but estimate that the remaining capital expenditures for 2006 will range from approximately $4,000,000 to $5,000,000 and may include additional costs associated with upgrades to our distribution centers, the build-out of new retail outlet stores and a new Teva trade show booth. The actual amount of capital expenditures for the remainder of 2006 may differ from this estimate, largely depending on any unforeseen needs to replace existing assets and the timing of expenditures.

We believe that internally generated funds, the available borrowings under our existing Facility and cash on hand will provide sufficient liquidity to enable us to meet our working capital requirements for at least the next twelve months. However, risks and uncertainties that could impact our ability to maintain our cash position include our growth rate, the continued strength of our brands, our ability to respond to changes in consumer preferences, our ability to collect our receivables in a timely manner, our ability to effectively manage our inventories and the volume of letters of credit used to purchase product, among others. See Risk Factors for a discussion of additional factors that may affect our working capital position. Furthermore, we may require additional cash resources due to changed business conditions or other future developments, including any investments or acquisitions we may decide to pursue. If these sources are insufficient to satisfy our cash requirement, we may seek to sell debt securities or additional equity securities or to obtain a new credit facility or draw on our existing Facility. The sale of convertible debt securities or additional equity securities could result in additional dilution to our stockholders. The incurrence of indebtedness would result in incurring debt service obligations and could result in operating and financial covenants that would restrict our operations. In addition, there can be no assurance that any additional financing will be available on acceptable terms, if at all. Although there are no present understandings, commitments or agreements with respect to the acquisition of any other businesses, we may, from time to time, evaluate acquisitions of other businesses or brands.

Contractual Obligations. The following table summarizes our contractual obligations at March 31, 2006, and the effects such obligations are expected to have on liquidity and cash flow in future periods.

	Payments Due by Period				
	Total	**Less than 1 Year**	**1-3 Years**	**3-5 Years**	**More than 5 Years**
Operating lease obligations	$15,390,000	$3,801,000	$7,135,000	$2,805,000	$1,649,000

Impact of Inflation

We believe that the relatively moderate rates of inflation in recent years have not had a significant impact on our net sales or profitability.

Critical Accounting Policies and Estimates

Revenue Recognition. We recognize revenue when products are shipped and the customer takes title and assumes risk of loss, collection of relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable. Allowances for estimated returns, discounts, and bad

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debts are provided for when related revenue is recorded. Amounts billed for shipping and handling costs are recorded as a component of net sales, while the related costs paid to third-party shipping companies are recorded as a cost of sales.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures about contingent liabilities and the reported amounts of net sales and expenses during the reporting period. Management bases these estimates and assumptions upon historical experience, existing, known circumstances, authoritative accounting pronouncements and other factors that management believes to be reasonable under the circumstances. Management reasonably could use different estimates and assumptions, and changes in estimates and assumptions could occur from period to period, with the result in each case being a potential material change in the financial statement presentation of our financial condition or results of operations. We have historically been accurate in our estimates used for the reserves and allowances below. We believe that the estimates and assumptions below are among those most important to an understanding of our condensed consolidated financial statements contained in this report.

Allowance for Doubtful Accounts. We provide a reserve against trade accounts receivable for estimated losses that may result from customers inability to pay. We determine the amount of the reserve by analyzing known uncollectible accounts, aged trade accounts receivables, economic conditions, historical experience and the customers credit-worthiness. Trade accounts receivable that are subsequently determined to be uncollectible are charged or written off against this reserve. The reserve includes specific reserves for accounts which are identified as potentially uncollectible, plus a non-specific reserve for the balance of accounts based on our historical loss experience with bad debts. Reserves have been established for all probable losses of this nature. The gross trade accounts receivable balance was $31,359,000 and the allowance for doubtful accounts was $1,294,000 at March 31, 2006, compared to gross trade accounts receivable of $48,067,000 and the allowance for doubtful accounts of $2,574,000 at December 31, 2005. The decrease in the allowance for doubtful accounts at March 31, 2006 compared to December 31, 2005 was primarily related to the decrease in the gross trade accounts receivable during the period as well as the collection of accounts for which we had previously reserved as doubtful. Our use of different estimates and assumptions in the calculation of our allowance for doubtful accounts could produce different financial results. For example, a 1.0% change in the rate used to estimate the reserve for the accounts not specifically identified as uncollectible would change the allowance for doubtful accounts at March 31, 2006 by $246,000.

Reserve for Sales Discounts. A significant portion of our domestic net sales and resulting trade accounts receivable reflects a discount that the customers may take, generally based upon meeting certain order, shipment and payment timelines. We estimate the amount of the discounts that are expected to be taken against the period-end trade accounts receivable and we record a corresponding reserve for sales discounts. We determine the amount of the reserve for sales discounts considering the amounts of available discounts in the period-end accounts receivable aging and historical discount experience, among other factors. The reserve for sales discounts was approximately $542,000 at March 31, 2006 and $1,710,000 at December 31, 2005. The decrease in the reserve for sales discounts at March 31, 2006 compared to December 31, 2005 was primarily due to the decrease in the gross trade accounts receivable during the period in addition to normal seasonality. Our use of different estimates and assumptions could produce different financial results. For example, a 10% change in the estimate of the percentage of accounts that will ultimately take their discount would change the reserve for sales discounts at March 31, 2006 by $52,000.

Allowance for Estimated Returns. We record an allowance for anticipated future returns of goods shipped prior to period-end. In general, we accept returns for damaged or defective products but discourage returns for other reasons. We base the amount of the allowance on any approved customer requests for returns, historical returns experience and any recent events that could result in a change in historical returns rates, among other factors. The allowance for returns decreased to $1,330,000 at March 31, 2006 from $2,865,000 at December 31, 2005, primarily as a result of lower net sales in the three months ended March 31, 2006

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compared to the three months ended December 31, 2005. Our use of different estimates and assumptions could produce different financial results. For example, a 1.0% change in the rate used to estimate the percentage of sales expected to ultimately be returned would change the reserve for returns at March 31, 2006 by approximately $378,000.

Inventory Write-Downs. Inventories are stated at lower of cost or market. We review the various items in inventory on a regular basis for excess, obsolete and impaired inventory. In doing so, we write the inventory down to the lower of cost or estimated future net selling prices. At March 31, 2006, inventories were stated at $31,281,000, net of inventory write-downs of $3,389,000. At December 31, 2005, inventories were stated at $33,374,000, net of inventory write-downs of $3,346,000. The increase in the reserve for inventory write-downs at March 31, 2006 compared to December 31, 2005 was primarily due to the increase in levels of older inventory as of March 31, 2006. Our use of different estimates and assumptions could produce different financial results. For example, a 10% change in estimated selling prices of our potentially obsolete inventory would change the inventory write-down amount at March 31, 2006 by approximately $590,000.

Valuation of Goodwill, Intangible and Other Long-Lived Assets. We periodically assess the impairment of goodwill, intangible and other long-lived assets on a separate asset basis based on assumptions and judgments regarding the carrying value of these assets individually. We test goodwill and nonamortizable intangible assets for impairment on an annual basis based on the fair value of the reporting unit (goodwill) or assets (nonamortizable intangibles) compared to its carrying value. We consider other long-lived assets to be impaired if we determine that the carrying value may not be recoverable. Among other considerations, we consider the following factors:

- the assets ability to continue to generate income from operations and positive cash flow in future periods;
- our future plans regarding utilization of the assets;
- any changes in legal ownership of rights to the assets; and
- changes in consumer demand or acceptance of the related brand names, products or features associated with the assets.

If we consider the assets to be impaired, we recognize an impairment loss equal to the amount by which the carrying value of the assets exceeds the estimated fair value of the assets. In addition, as it relates to long-lived assets, we base the useful lives and related amortization or depreciation expense on the estimate of the period that the assets will generate sales or otherwise be used by us.

Recent Accounting Pronouncements

The Company adopted SFAS 123R on January 1, 2006. The impact of the adoption is discussed in note 2 to the condensed consolidated financial statements above.

In November 2004, the FASB issued Statement of Financial Accounting Standards, or SFAS No. 151, Inventory Costs An Amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4 . SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing , to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS No. 151 is effective for fiscal years beginning after June 15, 2005 and was adopted on January 1, 2006. The adoption of this Statement did not have a material effect on our condensed consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections, a replacement of Accounting Principles Board Opinion (APB) No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. This Statement requires retrospective

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application to prior periods financial statements of a change in accounting principle. It applies both to voluntary changes and to changes required by an accounting pronouncement if the pronouncement does not include specific transition provisions. APB 20 previously required that most voluntary changes in accounting principles be recognized by recording the cumulative effect of a change in accounting principle. SFAS 154 is effective for fiscal years beginning after December 15, 2005. The Company adopted this statement on January 1, 2006, and it did not have a material effect on the financial statements upon adoption.

Risk Factors

Our short- and long-term success is subject to many factors beyond our control. Stockholders and potential stockholders should carefully consider the following risk factors in addition to the other information contained in this report and the information incorporated by reference in this report. If any of the following risks occur, our business, financial condition or results of operations could be adversely affected. In that case, the value of our common stock could decline and stockholders and potential stockholders may lose all or part of their investment.

Risks Relating to Our Business

Our success depends on our ability to anticipate fashion trends.

Our success depends largely on the continued strength of our Teva, UGG and Simple brands and on our ability to anticipate, understand and react to the rapidly changing fashion tastes of footwear consumers and to provide appealing merchandise in a timely manner. Our products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty and are subject to rapid change. We are also dependent on customer receptivity to our products and marketing strategy. There can be no assurance that consumers will continue to prefer our brands, that we will respond quickly enough to changes in consumer preferences or that we will successfully introduce new models and styles of footwear. Achieving market acceptance for new products also will likely require us to exert substantial marketing and product development efforts and expend significant funds to create consumer demand. A failure to introduce new products that gain market acceptance would erode our competitive position, which would reduce our profits and could adversely affect the image of our brands, resulting in long-term harm to our business.

Our UGG brand may not continue to grow at the same rate it has experienced in the recent past.

Our UGG brand has experienced strong growth over the past few years, with net wholesale sales of UGG products having increased from $34,561,000 in 2003 to $150,279,000 in 2005, representing a compound annual growth rate of 108.5%. We do not expect to sustain this growth rate in the future. UGG may be a fashion item that could go out of style at any time. UGG represents a significant portion of our business, and if UGG sales were to decline or to fail to increase in the future, our overall financial performance would be adversely affected.

We may experience shortages of top grade sheepskin, which could interrupt product manufacturing and increase product costs.

We depend on a limited number of key resources for sheepskin, the principal raw material for our UGG products. In 2005, four suppliers provided all of the sheepskin purchased by our independent manufacturers. The top grade sheepskin used in UGG footwear is in high demand and limited supply. In addition, sheep are susceptible to hoof and mouth disease, which can result in the extermination of an infected herd and could have a material adverse effect on the availability of top grade sheepskin for our products. Additionally, the supply of sheepskin can be adversely impacted by drought conditions. Our potential inability to obtain top grade sheepskin for UGG products could impair our ability to meet our production requirements for UGG in a timely manner and could lead to inventory shortages, which can result in lost potential sales,

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delays in shipments to customers, strain on our relationships with customers and diminished brand loyalty. Additionally, there have been significant increases in the prices of top grade sheepskin as the demand for this material has increased. Any further price increases will likely raise our costs, increase our costs of sales and decrease our profitability unless we are able to pass higher prices on to our customers.

If we do not accurately forecast consumer demand, we may have excess inventory to liquidate or have difficulty filling our customers orders.

Because the footwear industry has relatively long lead times for design and production, we must commit to production tooling and production volumes many months before consumer tastes become apparent. The footwear industry is subject to fashion risks and rapid changes in consumer preferences, as well as the effects of weather, general market conditions and other factors affecting demand. Our large number of models, colors and sizes in our three product lines exacerbates these risks. As a result, we may fail to accurately forecast styles and features that will be in demand. If we overestimate demand for our any products, styles or sku s, we may be forced to liquidate excess inventories at a discount to customers, resulting in higher markdowns and lower gross margins. Further, the excess inventories may prolong our cash flow cycle, resulting in reduced cash flow and increased liquidity risks. Conversely, if we underestimate consumer demand for any products, styles or sku s, we could have inventory shortages, which can result in lost potential sales, delays in shipments to customers, strains on our relationships with customers and diminished brand loyalty. This may be particularly true with regard to our UGG product line, which has experienced strong consumer demand and rapid sales growth.

We may not succeed in implementing our growth strategy.

As part of our growth strategy, we seek to enhance the positioning of our brands, extend our brands into complementary product categories and markets through licensing, expand geographically and improve our operational performance. We may not be able to successfully implement any or all of these strategies. If we fail to do so, our rate of growth may slow or our results of operations may decline, which in turn could have a negative effect on the value of our stock.

Our financial success is limited to the success of our customers.

Our financial success is directly related to the success of our customers and the willingness of our customers to continue to buy our products. We do not have long-term contracts with any of our customers. Sales to our customers are generally on an order-by-order basis and are subject to rights of cancellation and rescheduling by our customers. If we cannot fill our customers orders in a timely manner, our relationships with our customers may suffer, and this could have a material adverse effect on us. Furthermore, if any of our major customers experiences a significant downturn in its business, or fails to remain committed to our products or brands, then these customers may reduce or discontinue purchases from us, which could have a material adverse effect on our business, results of operations and financial condition.

Certain of our customers account for a significant portion of our sales and the loss of one or more of these key customers would significantly reduce our sales.

Our five largest customers accounted for approximately 27.0% of net sales in 2005 and 25.2% of net sales in 2004. Our single largest customer accounted for 15.8% of net sales in 2005 and 14.1% in 2004. Any potential loss of a key customer, or a significant reduction in sales to a key customer, could have a material adverse effect on our business, results of operations and financial condition.

Establishing and protecting our trademarks, patents and other intellectual property is costly and difficult. If our efforts to do so are unsuccessful, the value of our brands could suffer.

We believe that our trademarks and other intellectual property rights are of value and are integral to our success and our competitive position. Some countries laws do not protect intellectual property rights to the

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same extent as do U.S. laws. From time to time, we discover products in the marketplace that infringe upon our trademark, patent, copyright and other intellectual property. If we are unsuccessful in challenging a third party s products on the basis of patent and trade dress rights, continued sales of such competing products by third parties could adversely impact our business, financial condition and results of operations. Furthermore, our efforts to enforce our trademark and other intellectual property rights are typically met with defenses and counterclaims attacking the validity and enforceability of our trademark and other intellectual property rights. Similarly, from time to time we may be the subject of litigation challenging our ownership of intellectual property. Loss of our Teva, UGG or Simple trademark, patent or other intellectual property rights could have a material adverse effect on our business.

We face particularly strong challenges to our UGG trademark in Australia, where many Australian manufacturers sell competitive footwear on the Internet. Our trademark registrations in Australia are subject to challenge for non-use. In addition, certain Australia sheepskin boot manufacturers have asserted that the marks UGH and UGG are not valid as being generic terms for sheepskin boots. An administrative decision in the Australian trademark office has removed one of our Australian trademark registrations for UGH-BOOTS for non-use, and stated that ugg, ugh and ug are generic terms in Australia. However, only the Australian federal courts have jurisdiction to determine the issue. Our Australian registrations for UGG AUSTRALIA & Design and UGH are also being challenged for non-use, which we are contesting. If the challenges are successful, our rights in the trademarks, including our ability to prevent Australian competitors from using these trademarks in commerce in Australia, will be adversely affected. Although we derived less than 1% of our revenue in the UGG product line from Australian sales in 2005, our ability to prevent Australian competitors from using the marks on the Internet and in other channels of trade that may reach consumers in other countries, including the U.S., could also be adversely affected and the integrity of our UGG brand could be harmed by the association with inferior products.

We may lose pending litigation and the rights to certain of our intellectual property.

We are currently involved in several disputes, including cases pending in U.S. federal and foreign courts and in foreign trademark offices, regarding infringement by third parties of our trademarks, trade dress, copyrights, patents and other intellectual property and the validity of our intellectual property. Any decision or settlement in any of these disputes that renders our intellectual property invalid or unenforceable, or that allows a third party to continue to use our intellectual property in connection with products that are similar to ours could have an adverse effect on our sales and on our intellectual property, which could have a material adverse effect on our results of operations and financial condition.

Counterfeiting of our brands can divert sales and damage our brand image.

Our brands and designs are constantly at risk for counterfeiting and infringement of our intellectual property rights, and we frequently find counterfeit products and products that infringe on our intellectual property rights in our markets as well as domain names that use our trade names or trademarks without our consent. We have not always been successful, particularly in some foreign countries, in combating counterfeit products and stopping infringement of our intellectual property rights. Counterfeit and infringing products not only cause us to lose significant sales, but also can harm the integrity of our brands by associating our trademarks or designs with lesser quality or defective goods.

In particular, we are experiencing more infringers of our UGG trademark and more counterfeit products seeking to benefit from the consumer demand for our UGG products. Enforcement of our rights to the UGG trademarks faces many challenges due in part to the proliferation of the term UGG in third party domain names that promote counterfeit products or otherwise use the trademark UGG without our permission. In spite of our enforcement efforts, we expect such unauthorized use to continue, which could result in a loss of sales for authorized UGG products and a diminution in the goodwill associated with the UGG trademarks.

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As our patents expire, our competitors will be able to copy our technology or incorporate it in their products without paying royalties.

Patents generally have a life of 20 years from filing, and some of our patents will expire in the next ten years. For example, the patent for our Universal Strapping System used in many of our Teva sandals will expire in September 2007. Our Universal Strapping System is currently used in many of our Teva sandals. Once patent protection has expired, our competitors can copy our products or incorporate our innovations in their products without paying royalties. To combat this, we must continually create new designs and technology, obtain patent protection and incorporate the new technology or design in our footwear. We cannot provide assurance that we will be able to do so. Sales of our Teva sandals may decline significantly if we incorporate substitute technologies in lieu of our Universal Strapping System for our Teva sandals.

If our customers cancel existing orders, we may have excess inventory; if customers postpone delivery of existing orders to future periods, we may not achieve sales and earnings targets for the period, which could have a negative impact on our stock price.

We receive customer orders and indications of future orders, which we use to determine which inventory items to purchase. We also use the timing of delivery dates in our customer orders to forecast our sales and earnings for future periods. If our customers cancel existing orders, it may result in lower sales, as well as excess inventories that could lead to inventory write-downs and closeouts, resulting in lower gross margin. The excess inventories could also have a negative impact on our cash flow. If customers postpone delivery of their orders, we may not achieve our expected sales and earnings forecasts for the period, which could have a negative impact on our stock price.

Because we depend on independent manufacturers, we face challenges in maintaining a continuous supply of goods that meet our quality standards.

We use independent manufacturers to produce all of our products, with almost all of the production occurring among four manufacturers in China. We depend on these manufacturers ability to finance the production of goods ordered and to maintain manufacturing capacity. The manufacturers in turn depend upon their suppliers of raw materials. We do not exert direct control over either the independent manufacturers or their raw materials suppliers, so we may be unable to obtain timely delivery of acceptable products.

In addition, we do not have long-term contracts with these independent manufacturers, and any of them may unilaterally terminate their relationship with us at any time or seek to increase the prices they charge us. As a result, we are not assured of an uninterrupted supply of products of an acceptable quality from our independent manufacturers. If there is an interruption, we may not be able to substitute suitable alternative manufacturers because substitutes may not be available or they may not be able to provide us with products or services of a comparable quality, at an acceptable price or on a timely basis. If a change in our independent manufacturers becomes necessary, we would likely experience increased costs, as well as substantial disruption of our business and a resulting loss of sales.

Similarly, if we experience a significant increase in demand and a manufacturer is unable to ship orders of our products in accordance with our timing demands and our quality standards, we could miss customer delivery date requirements. This in turn could result in cancellation of orders, customer refusals of shipments or a reduction in selling prices, any of which could have a material adverse effect on our sales and financial condition. We compete with other companies for the production capacity and the import quota capacity of our manufacturers. Accordingly, our independent manufacturers may not produce and ship some or all of any orders placed by us.

If raw materials do not meet our specifications or if the prices of raw materials increase, we could experience a high return rate, a loss of sales or a reduction in our gross margins.

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Our independent manufacturers use various raw materials in the manufacture of our footwear that must meet our specifications generally and, in some cases, additional technical requirements for performance footwear. If these raw materials and the end product do not perform to our specifications or consumer satisfaction, we could experience a higher rate of customer returns and a diminution in the image of our brands, which could have a material adverse effect on our business, financial condition and results of operations.

There may be significant increases in the prices of the raw materials used in our footwear, which would increase the cost of our products from our independent manufacturers. Our gross profit margins are adversely affected to the extent that the selling prices of our products do not increase proportionately with increases in their costs. Any significant unanticipated increase in the prices of raw materials could materially affect our results of operations. No assurances can be given that we will be protected from future changes in the prices of such raw materials.

The costs of production and transportation of our products can increase as petroleum and other energy prices rise.

The manufacture and transportation of our products requires the use of petroleum-based materials and energy costs. Any future increases in the costs of these materials and energy sources will increase the cost of our goods which will reduce our gross margin unless we can successfully raise our selling prices to compensate for the increased costs.

Our independent manufacturers are located outside the U.S., where we are subject to the risks of international commerce.

All of our current third party manufacturers are in the Far East, New Zealand and Australia with substantially all production performed by four manufacturers in China. Foreign manufacturing is subject to numerous risks, including the following:

- tariffs, import and export controls and other non-tariff barriers such as quotas and local content rules, including the potential threat of anti-dumping duties and quotas which may be imposed by the European Union on the import of certain types of footwear from China;
- increasing transportation costs due to energy prices or other factors;
- poor infrastructure and shortages of equipment, which can delay or interrupt transportation and utilities;
- foreign currency fluctuations;
- restrictions on the transfer of funds;
- changing economic conditions;
- changes in governmental policies;
- environmental regulation;
- labor unrest, which can lead to work stoppages and interruptions in transportation or supply;
- shipping delays, including those resulting from labor issues, work stoppages or other delays at the port of entry or port of departure;

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political unrest, which can interrupt commerce and make travel dangerous; and

expropriation and nationalization.

In particular, because most of our products are manufactured in China, adverse change in trade or political relations with China or political instability in the Far East could severely interfere with the manufacture of our products and could materially adversely affect our results of operations. Uncertainty regarding the short-term and long-term effects of the severe acute respiratory syndrome, or SARS, and the outbreak of avian influenza in China and elsewhere in the Far East could disrupt the manufacture and transportation of our products, which would harm our results of operations.

We are also subject to general risks associated with managing foreign operations effectively and efficiently from the U.S. and understanding and complying with local laws, regulations and customs in foreign jurisdictions. These factors and the failure to properly respond to them could make it difficult to obtain adequate supplies of quality products when we need them, resulting in reduced sales and harm to our business.

Our business could suffer if our independent manufacturers or designated suppliers violate labor laws or fail to conform to our ethical standards.

We require our independent contract manufacturers and designated suppliers to meet our standards for working conditions, environmental compliance, human rights and other matters before we are willing to place business with them. We do not control our independent manufacturers, designated suppliers or their respective labor practices. If one of our independent contract manufacturers or designated suppliers violates our labor standards by, for example, using convicted, forced or indentured labor or child labor, fails to pay compensation in accordance with local law or fails to operate its factories in compliance with local safety or environmental standards, we likely would immediately cease dealing with that manufacturer or supplier, and we could suffer an interruption in our product supply chain. In addition, the manufacturers or designated suppliers actions could damage our reputation and the value of our brands, resulting in negative publicity and discouraging customers and consumers from buying our products.

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We may be unable to successfully identify, develop or acquire, and build new brands.

We intend to continue to focus on identifying, developing or acquiring and building new brands. Our search may not yield any complementary brands, and even if we do find a suitable brand we may not be able to obtain sufficient financing to fund the development or acquisition of the brand. We may not be able to successfully integrate the management of a new brand into our existing operations, and we cannot assure you that any developed or acquired brand will achieve the results we expect. We compete with other companies who have greater resources than we do for the opportunities to license brands or buy other brands. As a result, even if we do identify a suitable license or acquisition, we may lose the opportunity to a competitor who offers a more attractive price. In such event, we may incur significant costs in pursuing a license or an acquisition without success.

Our quarterly sales and operating results may fluctuate in future periods, and if we fail to meet expectations the price of our common stock may decline.

Our quarterly sales and operating results have fluctuated significantly in the past and are likely to do so in the future due to a number of factors, many of which are not within our control. If our quarterly sales or operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially. Factors that might cause quarterly fluctuations in our sales and operating results include the following:

- variation in demand for our products, including variation due to changing consumer tastes and seasonality;

- our ability to develop, introduce, market and gain market acceptance of new products and product enhancements in a timely manner;

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- our ability to manage inventories, accounts receivable and cash flows;
- our ability to control costs;
- the size, timing, rescheduling or cancellation of orders from customers;
- the introduction of new products by competitors;
- the availability and reliability of raw materials used to manufacture our products;
- changes in our pricing policies or those of our independent manufacturers and competitors, as well as increased price competition in general;
- the mix of our domestic and international sales, and the risks and uncertainties associated with our international business;
- our ability to forecast future sales and operating results and subsequently attain them;
- developments concerning the protection of our intellectual property rights; and
- general global economic and political conditions, including international conflicts and acts of terrorism.

In addition, our expenses depend, in part, on our expectations regarding future sales. In particular, we expect to continue incurring substantial expenses relating to the marketing and promotion of our products. Since many of our costs are fixed in the short term, if we have a shortfall in sales, we may be unable to reduce expenses quickly enough to avoid losses. Accordingly, you should not rely on quarter-to-quarter comparisons of our operating results as an indication of our future performance.

Loss of the services of our key personnel could adversely affect our business.

Our future success and growth depend on the continued services of Angel R. Martinez, President and Chief Executive Officer, Zohar Ziv, Chief Financial Officer and Executive Vice President of Finance and Administration, Constance X. Rishwain, President of the UGG and Simple Divisions, Peter K. Worley, President of the Teva Division, Patrick C. Devaney, Senior Vice President of Global Sourcing, Production and Development, Colin G. Clark, Senior Vice President, International, and John A. Kalinich, Vice President of Consumer Direct, as well as other key officers and employees. The loss of the services of any of these individuals or any other key employee could materially affect our business. Our future success depends on our ability to identify, attract and retain additional qualified personnel and to identify and hire suitable replacements for departing employees in key positions on a timely basis. Competition for employees in our industry is intense and we may not be successful in attracting or retaining them.

We conduct business outside the U.S., which exposes us to foreign currency and other risks.

Our products are manufactured outside the U.S., and our independent manufacturers procure most of their supplies outside the U.S. We sell our products in the U.S. and internationally. Although we pay for the purchase and manufacture of our products primarily in U.S. dollars and we sell our products primarily in U.S. dollars, we are routinely subject to currency rate movements on non-U.S. denominated assets, liabilities and income since our foreign distributors sell in local currencies, which impacts the price to foreign customers. We currently do not use currency hedges since substantially all our transactions are in U.S. dollars. Future changes in foreign currency exchange rates may cause changes in the dollar value of our purchases or sales and materially affect our results of operations.

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The People s Republic of China has recently revalued its currency and abandoned its peg to the U.S. dollar. We currently source substantially all production from China. While our purchases from the Chinese factories are currently denominated in U.S. dollars, certain operating and manufacturing costs of the factories are denominated in the Chinese currency. As a result, this change or any further revaluations in the Chinese currency versus the U.S. dollar could impact our purchase prices from the factories in the event that they adjust their selling prices accordingly. Any increase in our footwear purchase costs will reduce our gross margin unless we are able to raise our selling prices to our customers in order to compensate for the increased costs.

Our most popular products are seasonal, and our sales are sensitive to weather conditions.

Sales of our products, particularly those under the Teva and UGG brands, are highly seasonal and are sensitive to weather conditions. Extended periods of unusually cold weather during the spring and summer can reduce demand for Teva footwear and therefore, result in lower sales. Likewise, unseasonably warm weather during the fall and winter months may reduce demand for our UGG products. The effect of favorable or unfavorable weather on sales can be significant enough to affect our quarterly results, with a resulting effect on our common stock price.

We depend on independent distributors to sell our products in international markets.

We sell our products in international markets through independent distributors. If a distributor fails to meet annual sales goals, it may be difficult and costly to locate an acceptable substitute distributor. If a change in our distributors becomes necessary, we may experience increased costs, as well as substantial disruption and a resulting loss of sales.

Our sales in international markets are subject to a variety of laws and political and economic risks that may adversely impact our sales and results of operations in certain regions.

Our ability to capitalize on growth in new international markets and to maintain the current level of operations in our existing international markets is subject to risks associated with international sales operations. These include:

- changes in currency exchange rates which impact the price to international consumers;

- the burdens of complying with a variety of foreign laws and regulations;

- unexpected changes in regulatory requirements; and

- the difficulties associated with promoting products in unfamiliar cultures.

We are also subject to general political and economic risks in connection with our international sales operations, including:

- political instability;

- changes in diplomatic and trade relationships; and

- general economic fluctuations in specific countries or markets.

Any of the abovementioned factors could adversely affect our sales and results of operations in international markets.

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International trade regulations may impose unexpected duty costs or other non-tariff barriers to markets while the increasing number of free trade agreements has the potential to stimulate increased competition; security procedures may cause significant delays.

Products manufactured overseas and imported into the U.S. and other countries are subject to import duties. While we have implemented internal measures to comply with applicable customs regulations and to properly calculate the import duties applicable to imported products, customs authorities may disagree with our claimed tariff treatment for certain products, resulting in unexpected costs that may not have been factored into the sales price of the products.

We cannot predict whether future domestic laws, regulations or trade remedy actions or international agreements may impose additional duties or other restrictions on the importation of products from one or more of our sourcing venues. Such changes could increase the cost of our products, require us to withdraw from certain restricted markets or change our business methods, and could generally make it difficult to obtain products of our customary quality at a desired price. Meanwhile, the continued negotiation of bilateral and multilateral free trade agreements by the U.S. and our other market countries with countries other than our principal sourcing venues may stimulate competition from manufacturers in these other sourcing venues, which now export, or may seek to export, footwear to our market countries at preferred rates of duty, though we are uncertain precisely what effect these new agreements may have on our operations.

The European Union is currently considering imposing anti-dumping duties and quotas on importations of certain types of footwear from China. Any increase in duties or the requirement for quotas will increase the cost of our products and may limit the amount of China-sourced products that we are able to sell to the European market. Because the vast majority of our footwear is currently produced in China, the imposition of anti-dumping duties or quotas on products manufactured in China will have a negative impact on our sales and gross margin in the European market.

Finally, the increased threat of terrorist activity and the law enforcement responses to this threat have required greater levels of inspection of imported goods and have caused delays in bringing imported goods to market. Any tightening of security procedures, for example, in the aftermath of a terrorist incident, could worsen these delays.

We depend on our computer and communications systems.

We extensively utilize computer and communications systems to operate our Internet and catalog business and manage our internal operations. Any interruption of this service from power loss, telecommunications failure, failure of our computer system, failure due to weather, natural disasters or any similar event could disrupt our operations and result in lost sales. In addition, hackers and computer viruses have disrupted operations at many major companies. We may be vulnerable to similar acts of sabotage, which could have a material adverse effect on our business and operations.

We rely on our management information systems to operate our business and to track our operating results. Our management information systems will require modification and refinement as we grow and our business needs change. If we experience a significant system failure or if we are unable to modify our management information systems to respond to changes in our business needs, then our ability to properly run our business could be adversely affected.

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Risks Related to Our Industry

Because the footwear market is sensitive to decreased consumer spending and slow economic cycles, if general economic conditions deteriorate many of our customers may significantly reduce their purchases from us or may not be able to pay for our products in a timely manner.

The footwear industry historically has been subject to cyclical variation and decline in performance when consumer spending decreases or softness appears in the retail market. Many factors affect the level of consumer spending in the footwear industry, including:

- general business conditions;
- interest rates;
- the availability of consumer credit;
- weather;
- taxation; and
- consumer confidence in future economic conditions.

Consumer purchases of discretionary items, including our products, may decline during recessionary periods and also may decline at other times when disposable income is lower. A downturn in economies where our licensing partners or we sell products, whether in the U.S. or abroad, may reduce sales.

In addition, we extend credit to our customers based on an evaluation of each customer s financial condition. Many retailers, including some of our customers, have experienced financial difficulties during the past several years, thereby increasing the risk that such customers may not be able to pay for our products in a timely manner. Our bad debt expense may increase relative to net sales in the future. Any significant increase in our bad debt expense relative to net sales would adversely impact our net income and cash flow and could affect our ability to pay our own obligations as they become due.

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.

The footwear industry is highly competitive, and the recent growth in the market for sport sandals, casual footwear and other products manufactured by our licensees has encouraged the entry of many new competitors into the marketplace as well as increased competition from established companies. A number of our competitors have significantly greater financial, technological, engineering, manufacturing, marketing and distribution resources than we do, as well as greater brand awareness in the footwear market. Our competitors include athletic and footwear companies, branded apparel companies and retailers with their own private labels. 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, access to offshore manufacturing has made it easier for new companies to enter the markets in which we compete, further increasing competition in the footwear industry.

Additionally, efforts by our competitors to dispose of their excess inventories may significantly reduce prices that we can expect to receive for the sale of our competing products and may cause our customers to shift their purchases away from our products.

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We believe that our ability to compete successfully depends on a number of factors, including the quality, style and authenticity of our products and the strength of our brands, as well as many factors beyond our control. Maintaining our competitiveness depends on our ability to defend our products from infringement, our continued ability to anticipate and react to consumer tastes and our continued ability to deliver quality products at an acceptable price. If we fail to compete successfully in the future, our sales and profits will decline, as will the value of our business, financial condition and common stock.

Consolidations, restructurings and other ownership changes in the retail industry could affect the ability of our wholesale customers to purchase and market our products.

In the future, retailers in the U.S. and in foreign markets may undergo changes that could decrease the number of stores that carry our products or increase the concentration of ownership within the retail industry, including:

- consolidating their operations;
- undergoing restructurings;
- undergoing reorganizations; or
- realigning their affiliations.

These consolidations could result in a shift of bargaining power to the retail industry and in fewer outlets for our products. Further consolidations could result in price and other competition that could reduce our margins and our net sales.

Terrorism, government response to terrorism and other world events could affect our ability to do business.

We market and sell our products and services throughout the world. The September 11, 2001 terrorist attacks disrupted commerce across the U.S. and in many other parts of the world. World events, including the threat of similar attacks in the future, and the impact of the U.S. s military campaigns may cause significant disruption to commerce throughout the world. We are unable to predict whether the threat of new attacks or the resulting response will result in any long-term commercial disruptions or do long-term harm to our business, results of operations or financial condition. To the extent that future disruptions further slow the global economy or, more particularly, result in delays or cancellations of purchase orders for our products or delays in shipping, our business and results of operations could suffer material damage.

Risks Relating to Our Common Stock

Our common stock price has been volatile, which could result in substantial losses for stockholders.

Our common stock is traded on the NASDAQ National Market. While our average daily trading volume for the 52-week period ended May 5, 2006 was approximately 487,000 shares, we have experienced more limited volume in the past and may do so in the future. The trading price of our common stock has been and may continue to be volatile. The closing sale prices of our common stock, as reported by the NASDAQ National Market, have ranged from $17.15 to $43.56 for the 52-week period ended May 5, 2006. The trading price of our common stock could be affected by a number of factors, including, but not limited to the following:

- changes in expectations of our future performance;
- changes in estimates by securities analysts (or failure to meet such estimates);

- quarterly fluctuations in our sales and financial results;
- broad market fluctuations in volume and price; and
- a variety of risk factors, including the ones described elsewhere in this report.

Accordingly, the price of our common stock is volatile and any investment in our securities is subject to risk of loss.

Future sales of our common stock could adversely affect our stock price.

Future sales of substantial amounts of shares of our common stock by the Company in the public market, or the perception that these sales could occur, may cause the market price of our common stock to decline. In addition, we may be required to issue additional shares upon exercise of previously granted options that are currently outstanding.

Anti-takeover provisions of our certificate of incorporation, bylaws, stockholder rights plan and Delaware law could prevent or delay a change in control of our company, even if such a change of control would benefit our stockholders.

Provisions of our certificate of incorporation and bylaws, as well as provisions of Delaware law, could discourage, delay or prevent a merger, acquisition or other change in control of our company, even if such a change in control might benefit our stockholders. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors and take other corporate actions. As a result, these provisions could limit the price that investors are willing to pay in the future for shares of our common stock. These provisions might also discourage a potential acquisition proposal or tender offer, even if the acquisition proposal or tender offer is at a price above the then current market price for our common stock. These provisions include the following:

- a board of directors that is classified so that only one-third of directors stand for election each year;
- authorization of blank check preferred stock, which our board of directors could issue with provisions designed to thwart a takeover attempt;
- limitations on the ability of stockholders to call special meetings of stockholders;
- a prohibition against stockholder action by written consent and a requirement that all stockholder actions be taken at a meeting of our stockholders; and
- advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings.

We adopted a stockholder rights plan in 1998 under a stockholder rights agreement intended to protect stockholders against unsolicited attempts to acquire control of our company that do not offer what our board of directors believes to be an adequate price to all stockholders or that our board of directors otherwise opposes. As part of the plan, our board of directors declared a dividend that resulted in the issuance of one preferred share purchase right for each outstanding share of our common stock. Unless extended, the preferred share purchase rights will terminate on November 11, 2008. If a bidder proceeds with an unsolicited attempt to purchase our stock and acquires 20% or more (or announces its intention to acquire 20% or more) of our outstanding stock, and the board of directors does not redeem the preferred stock purchase right, the right will become exercisable at a price that significantly dilutes the interest of the bidder in our common stock.

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The effect of the stockholder rights plan is to make it more difficult to acquire our company without negotiating with the board of directors. However, the stockholder rights plan could discourage offers even if made at a premium over the market price of our common stock, and even if the stockholders might believe the transaction would benefit them.

In addition, we are subject to Section 203 of the Delaware General Corporation Law, which limits business combination transactions with 15% or greater stockholders that our board of directors has not approved. These provisions and other similar provisions make it more difficult for a third party to acquire us without negotiation. These provisions apply even if some stockholders would consider the transaction beneficial.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Derivative Instruments

Although we have used foreign currency hedges in the past, we no longer utilize forward contracts or other derivative instruments to mitigate exposure to fluctuations in the foreign currency exchange rate as all of our purchases and sales for the foreseeable future will be denominated in U.S. currency.

Although our sales are denominated in U.S. currency, our sales may be impacted by fluctuations in the exchange rates between the U.S. dollar and the local currencies in the international markets where our products are sold. If the U.S. dollar strengthens, it may result in increased pricing pressure on our distributors, which may have a negative impact on our net sales. We are unable to estimate the amount of any impact on sales attributed to pricing pressures caused by fluctuations in exchange rates.

Market Risk

Our market risk exposure with respect to financial instruments is to changes in the prime rate in the U.S. and changes in LIBOR. Our revolving line of credit provides for interest on outstanding borrowings at rates tied to the prime rate or at our election tied to LIBOR. At March 31, 2006, we had no outstanding borrowings under the revolving line of credit. A 1.0% increase in interest rates on our current borrowings would have no impact on income before income taxes.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer, Angel R. Martinez, and Chief Financial Officer, Zohar Ziv, with the participation of our management, carried out an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)). Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and (ii) that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity s disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors, mistakes or intentional circumvention of the established processes. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving our disclosure objectives.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 1. Legal Proceedings.

We are involved in routine litigation arising in the ordinary course of business. Such routine matters, if decided adversely to us, would not, in the opinion of management, have a material adverse effect on our financial condition or results of operations. Additionally, we have many pending disputes in the U.S. Patent and Trademark Office, foreign trademark offices and U.S. federal and foreign courts regarding unauthorized use or registration of our Teva, UGG and Simple trademarks. We also are aware of many instances throughout the world in which a third party is using our UGG trademark within its Internet domain name, and we have discovered and are investigating several manufacturers and distributors of counterfeit Teva and UGG products. We have contacted a majority of these unauthorized users and counterfeiters and in some instances may have to escalate the enforcement of our rights by filing suit against the unauthorized users and counterfeiters. Any decision or settlement in any of these matters that allowed a third party to continue to use our Teva, UGG or Simple trademarks or a domain name with our UGG trademark in connection with the sale of products similar to our products or to continue to manufacture or distribute counterfeit products could have an adverse effect on our sales and on our intellectual property, which could have a material adverse effect on our results of operations and financial condition.

Item 1A. Risk Factors.

There are no material changes from risk factors as previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, filed on March 9, 2006.

Our management deals with many risks and uncertainties in the normal course of business. The risks and uncertainties described under Management s Discussion and Analysis of Financial Conditions and Results of Operations Risk Factors in this Quarterly Report on Form 10-Q and Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 are not the only ones the Company faces. Additional risks and uncertainties not presently known to the Company or that the Company currently deems immaterial also may impair the Company s business operations. Readers should be aware that if any of the risks, uncertainties and events described therein or elsewhere in this Form 10-Q occur, the Company s business, financial condition or results of operations could be adversely affected.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

Not applicable

Item 3. Defaults upon Senior Securities.

Not applicable

Item 4. Submission of Matters to a Vote of Security Holders.

Not applicable

Item 5. Other Information.

Not applicable

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Item 6. Exhibits.

The exhibits to this report are listed in the Exhibit Index on page 43 of this report.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	Deckers Outdoor Corporation
Date: May 10, 2006	/s/ Zohar Ziv
	Zohar Ziv *Chief Financial Officer*
	(Duly Authorized Officer on Behalf of the Registrant and Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Description of Exhibit
3.1(1)	Amended and Restated Certificate of Incorporation of Deckers Outdoor Corporation (Exhibit 3.1 to the Registrant s Registration Statement on Form S-1, File No. 33-67248 and incorporated by reference herein)
3.2(1)	Restated Bylaws of Deckers Outdoor Corporation (Exhibit 3.2 to the Registrant s Registration Statement on Form S-1, File No. 33-47097 and incorporated by reference herein)
10.1#	Employment Agreement between the Company and Zohar Ziv, dated March 6, 2006 (Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on March 10, 2006)
10.2#	Employment Agreement between the Company and Peter Worley, dated March 17, 2006 (Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on March 20, 2006)
10.3#	Amendment No. 1 to Amended and Restated Employment Agreement between the Company and Douglas B. Otto, effective April 11, 2005 (Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on April 7, 2006)
10.4#	Employment Agreement between the Company and Constance X. Rishwain, dated April 3, 2006 (Incorporated by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K filed on April 7, 2006)
10.5#	Employment Agreement between the Company and Patrick C. Devaney, dated April 3, 2006 (Incorporated by reference to Exhibit 10.3 to the Company s Current Report on Form 8-K filed on April 7, 2006)
10.6#	Employment Agreement between the Company and Colin G. Clark, dated April 17, 2006 (Incorporated by reference to Exhibit 10.1 to the Company s Current Report on Form 8-K filed on April 18, 2006)
10.7#	Employment Agreement between the Company and Janice M. Howell, dated April 17, 2006 (Incorporated by reference to Exhibit 10.2 to the Company s Current Report on Form 8-K filed on April 18, 2006)
10.8#	Amendment No. 1 to Employment Agreement between the Company and John A. Kalinich, effective January 1, 2006 (Incorporated by reference to Exhibit 10.3 to the Company s Current Report on Form 8-K filed on April 18, 2006)
31.1*	Certification of Chief Executive Officer, Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	

	Certification of Chief Financial Officer, Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32*	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference.

Management contract or compensatory plan or arrangement.

* Filed herewith.