

Under Armour, Inc.  
Form 10-Q  
November 05, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2008

or

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

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

Commission File No. 001-33202

**UNDER ARMOUR, INC.**

(Exact name of registrant as specified in its charter)

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**Maryland**  
(State or other jurisdiction of  
incorporation or organization)

**52-1990078**  
(I.R.S. Employer  
Identification No.)

**1020 Hull Street**  
**Baltimore, Maryland 21230**

(Address of principal executive offices) (Zip Code)

**(410) 454-6428**

(Registrant's telephone number, including area code)

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

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

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

Class A Common Stock, \$.0003 <sup>1</sup>/3 par value, 36,791,229 shares outstanding as of October 31, 2008 and Class B Convertible Common Stock, \$.0003 <sup>1</sup>/3 par value, 12,500,000 shares outstanding as of October 31, 2008.

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**UNDER ARMOUR, INC.**

**September 30, 2008**

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Under Armour, Inc. and Subsidiaries****Consolidated Balance Sheets****(In thousands, except share data)**

|                                                                                                                                                                                                                                                         | <b>September 30,<br/>2008<br/>(unaudited)</b> | <b>December 31,<br/>2007</b> |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------|------------------------------|
| <b>Assets</b>                                                                                                                                                                                                                                           |                                               |                              |
| Current assets                                                                                                                                                                                                                                          |                                               |                              |
| Cash and cash equivalents                                                                                                                                                                                                                               | \$ 40,152                                     | \$ 40,588                    |
| Accounts receivable, net of allowance for doubtful accounts of \$2,200 and \$1,112 as of September 30, 2008 and December 31, 2007, respectively                                                                                                         | 151,086                                       | 93,515                       |
| Inventories                                                                                                                                                                                                                                             | 163,612                                       | 166,082                      |
| Income taxes receivable                                                                                                                                                                                                                                 | -                                             | 614                          |
| Prepaid expenses and other current assets                                                                                                                                                                                                               | 19,571                                        | 11,028                       |
| Deferred income taxes                                                                                                                                                                                                                                   | 13,364                                        | 10,418                       |
| Total current assets                                                                                                                                                                                                                                    | 387,785                                       | 322,245                      |
| Property and equipment, net                                                                                                                                                                                                                             | 70,645                                        | 52,332                       |
| Intangible assets, net                                                                                                                                                                                                                                  | 5,877                                         | 6,470                        |
| Deferred income taxes                                                                                                                                                                                                                                   | 6,703                                         | 8,173                        |
| Other non-current assets                                                                                                                                                                                                                                | 3,876                                         | 1,393                        |
| Total assets                                                                                                                                                                                                                                            | \$ 474,886                                    | \$ 390,613                   |
| <b>Liabilities and Stockholders' Equity</b>                                                                                                                                                                                                             |                                               |                              |
| Current liabilities                                                                                                                                                                                                                                     |                                               |                              |
| Revolving credit facility                                                                                                                                                                                                                               | \$ 15,000                                     | \$ -                         |
| Accounts payable                                                                                                                                                                                                                                        | 63,265                                        | 55,012                       |
| Accrued expenses                                                                                                                                                                                                                                        | 33,201                                        | 36,111                       |
| Income taxes payable                                                                                                                                                                                                                                    | 10,238                                        | -                            |
| Current maturities of long term debt                                                                                                                                                                                                                    | 7,192                                         | 4,111                        |
| Current maturities of capital lease obligations                                                                                                                                                                                                         | 410                                           | 465                          |
| Deferred income taxes                                                                                                                                                                                                                                   | 418                                           | -                            |
| Total current liabilities                                                                                                                                                                                                                               | 129,724                                       | 95,699                       |
| Long term debt, net of current maturities                                                                                                                                                                                                               | 14,805                                        | 9,298                        |
| Capital lease obligations, net of current maturities                                                                                                                                                                                                    | 157                                           | 458                          |
| Other long term liabilities                                                                                                                                                                                                                             | 10,425                                        | 4,673                        |
| Total liabilities                                                                                                                                                                                                                                       | 155,111                                       | 110,128                      |
| <b>Commitments and contingencies (see Note 6)</b>                                                                                                                                                                                                       |                                               |                              |
| <b>Stockholders' equity</b>                                                                                                                                                                                                                             |                                               |                              |
| Class A Common Stock, \$.0003 1/3 par value; 100,000,000 shares authorized as of September 30, 2008 and December 31, 2007; 36,785,067 issued and outstanding as of September 30, 2008, 36,189,564 shares issued and outstanding as of December 31, 2007 | 12                                            | 12                           |

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Class B Convertible Common Stock, \$.0003 1/3 par value; 12,500,000 shares authorized, issued and outstanding as of September 30, 2008 and December 31, 2007

|                                                |                |                |
|------------------------------------------------|----------------|----------------|
|                                                | 4              | 4              |
| Additional paid-in capital                     | 171,579        | 162,362        |
| Retained earnings                              | 147,690        | 117,782        |
| Unearned compensation                          | (82)           | (182)          |
| Accumulated other comprehensive income         | 572            | 507            |
| <b>Total stockholders' equity</b>              | <b>319,775</b> | <b>280,485</b> |
| <br>Total liabilities and stockholders' equity | <br>\$ 474,886 | <br>\$ 390,613 |

See accompanying notes.

**Table of Contents****Under Armour, Inc. and Subsidiaries****Consolidated Statements of Income****(In thousands, except per share amounts)**

|                                                   | <b>Three Months Ended<br/>September 30,</b> |                    | <b>Nine Months Ended<br/>September 30,</b> |                    |
|---------------------------------------------------|---------------------------------------------|--------------------|--------------------------------------------|--------------------|
|                                                   | <b>2008</b>                                 | <b>2007</b>        | <b>2008</b>                                | <b>2007</b>        |
|                                                   | <i>(unaudited)</i>                          | <i>(unaudited)</i> | <i>(unaudited)</i>                         | <i>(unaudited)</i> |
| Net revenues                                      | \$ 231,946                                  | \$ 186,863         | \$ 545,965                                 | \$ 431,723         |
| Cost of goods sold                                | 113,679                                     | 92,346             | 281,959                                    | 217,526            |
| Gross profit                                      | 118,267                                     | 94,517             | 264,006                                    | 214,197            |
| Operating expenses                                |                                             |                    |                                            |                    |
| Selling, general and administrative expenses      | 71,788                                      | 60,708             | 209,954                                    | 156,186            |
| Income from operations                            | 46,479                                      | 33,809             | 54,052                                     | 58,011             |
| Other income (expense), net                       | (1,736)                                     | 674                | (2,012)                                    | 2,868              |
| Income before income taxes                        | 44,743                                      | 34,483             | 52,040                                     | 60,879             |
| Provision for income taxes                        | 19,080                                      | 14,453             | 22,132                                     | 25,196             |
| Net income                                        | \$ 25,663                                   | \$ 20,030          | \$ 29,908                                  | \$ 35,683          |
| <b>Net income available per common share</b>      |                                             |                    |                                            |                    |
| Basic                                             | \$ 0.53                                     | \$ 0.42            | \$ 0.62                                    | \$ 0.74            |
| Diluted                                           | \$ 0.51                                     | \$ 0.40            | \$ 0.60                                    | \$ 0.71            |
| <b>Weighted average common shares outstanding</b> |                                             |                    |                                            |                    |
| Basic                                             | 48,647                                      | 48,183             | 48,529                                     | 47,926             |
| Diluted                                           | 49,934                                      | 50,085             | 49,908                                     | 49,929             |

See accompanying notes.

**Table of Contents****Under Armour, Inc. and Subsidiaries****Consolidated Statements of Stockholders' Equity and Comprehensive Income****(Unaudited; in thousands)**

|                                                                    | <b>Class A</b>      |               | <b>Class B</b>      |               | <b>Additional<br/>Paid-In<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>Unearned<br/>Compensation</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income</b> |             | <b>Total<br/>Stockholders'<br/>Equity</b> |
|--------------------------------------------------------------------|---------------------|---------------|---------------------|---------------|-------------------------------------------|------------------------------|----------------------------------|-----------------------------------------------------------|-------------|-------------------------------------------|
|                                                                    | <b>Common Stock</b> |               | <b>Common Stock</b> |               |                                           |                              |                                  | <b>Income</b>                                             | <b>Loss</b> |                                           |
|                                                                    | <b>Shares</b>       | <b>Amount</b> | <b>Shares</b>       | <b>Amount</b> |                                           |                              |                                  |                                                           |             |                                           |
| <b>Balance as of December 31, 2007</b>                             | 36,190              | \$ 12         | 12,500              | \$ 4          | \$ 162,362                                | \$ 117,782                   | \$ (182)                         | \$ 507                                                    |             | \$ 280,485                                |
| Exercise of stock options                                          | 210                 | -             | -                   | -             | 648                                       | -                            | -                                | -                                                         |             | 648                                       |
| Issuance of Class A Common Stock, net of forfeitures               | 385                 | -             | -                   | -             | 909                                       | -                            | -                                | -                                                         |             | 909                                       |
| Stock-based compensation expense                                   | -                   | -             | -                   | -             | 5,778                                     | -                            | 100                              | -                                                         |             | 5,878                                     |
| Net excess tax benefits from stock-based compensation arrangements | -                   | -             | -                   | -             | 1,882                                     | -                            | -                                | -                                                         |             | 1,882                                     |
| Comprehensive income:                                              |                     |               |                     |               |                                           |                              |                                  |                                                           |             |                                           |
| Net income                                                         | -                   | -             | -                   | -             | -                                         | 29,908                       | -                                | -                                                         | \$          | 29,908                                    |
| Foreign currency translation adjustment, net of tax \$5            | -                   | -             | -                   | -             | -                                         | -                            | -                                | 65                                                        |             | 65                                        |
| Comprehensive income                                               |                     |               |                     |               |                                           |                              |                                  |                                                           | \$          | 29,973                                    |
|                                                                    |                     |               |                     |               |                                           |                              |                                  |                                                           |             | 29,973                                    |
| <b>Balance as of September 30, 2008</b>                            | 36,785              | \$ 12         | 12,500              | \$ 4          | \$ 171,579                                | \$ 147,690                   | \$ (82)                          | \$ 572                                                    |             | \$ 319,775                                |
| <b>Balance as of December 31, 2006</b>                             | 34,556              | \$ 12         | 13,250              | \$ 4          | \$ 148,562                                | \$ 66,376                    | \$ (463)                         | \$ (103)                                                  |             | \$ 214,388                                |
| Exercise of stock options                                          | 585                 | -             | -                   | -             | 1,886                                     | -                            | -                                | -                                                         |             | 1,886                                     |
| Issuance of Class A Common Stock, net of forfeitures               | 201                 | -             | -                   | -             | 727                                       | -                            | -                                | -                                                         |             | 727                                       |
| Stock-based compensation expense                                   | -                   | -             | -                   | -             | 2,732                                     | -                            | 234                              | -                                                         |             | 2,966                                     |
| Net excess tax benefits from stock-based compensation arrangements | -                   | -             | -                   | -             | 5,820                                     | -                            | -                                | -                                                         |             | 5,820                                     |
| Effect of adoption of FIN 48                                       | -                   | -             | -                   | -             | -                                         | (1,152)                      | -                                | -                                                         |             | (1,152)                                   |
| Comprehensive income:                                              |                     |               |                     |               |                                           |                              |                                  |                                                           |             |                                           |
| Net income                                                         | -                   | -             | -                   | -             | -                                         | 35,683                       | -                                | -                                                         | \$          | 35,683                                    |
| Foreign currency translation adjustment, net of tax \$302          | -                   | -             | -                   | -             | -                                         | -                            | -                                | 461                                                       |             | 461                                       |
| Comprehensive income                                               |                     |               |                     |               |                                           |                              |                                  |                                                           | \$          | 36,144                                    |
|                                                                    |                     |               |                     |               |                                           |                              |                                  |                                                           |             | 36,144                                    |
| <b>Balance as of September 30, 2007</b>                            | 35,342              | \$ 12         | 13,250              | \$ 4          | \$ 159,727                                | \$ 100,907                   | \$ (229)                         | \$ 358                                                    |             | \$ 260,779                                |

See accompanying notes.





**Table of Contents****Under Armour, Inc. and Subsidiaries****Consolidated Statements of Cash Flows****(In thousands)**

|                                                                                            | <b>Nine Months Ended<br/>September 30,</b> |                    |
|--------------------------------------------------------------------------------------------|--------------------------------------------|--------------------|
|                                                                                            | <b>2008</b>                                | <b>2007</b>        |
|                                                                                            | <b>(unaudited)</b>                         | <b>(unaudited)</b> |
| <b>Cash flows from operating activities</b>                                                |                                            |                    |
| Net income                                                                                 | \$ 29,908                                  | \$ 35,683          |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities |                                            |                    |
| Depreciation and amortization                                                              | 15,483                                     | 9,996              |
| Unrealized foreign currency exchange rate (gains) losses                                   | 1,517                                      | (2,321)            |
| Loss on disposal of property and equipment                                                 | 29                                         | -                  |
| Stock-based compensation                                                                   | 5,878                                      | 2,966              |
| Deferred income taxes                                                                      | (1,166)                                    | (6,309)            |
| Changes in reserves for doubtful accounts, returns, discounts and inventories              | 2,704                                      | 6,505              |
| Changes in operating assets and liabilities:                                               |                                            |                    |
| Accounts receivable                                                                        | (60,777)                                   | (59,792)           |
| Inventories                                                                                | 1,430                                      | (70,881)           |
| Prepaid expenses and other assets                                                          | (8,705)                                    | (4,929)            |
| Accounts payable                                                                           | 8,623                                      | 23,940             |
| Accrued expenses and other liabilities                                                     | 772                                        | 8,309              |
| Income taxes payable and receivable                                                        | 10,857                                     | 9,933              |
| Net cash provided by (used in) operating activities                                        | 6,553                                      | (46,900)           |
| <b>Cash flows from investing activities</b>                                                |                                            |                    |
| Purchase of property and equipment                                                         | (30,848)                                   | (26,237)           |
| Purchase of intangible assets                                                              | -                                          | (125)              |
| Purchase of trust owned life insurance policies                                            | (2,868)                                    | -                  |
| Proceeds from sales of property and equipment                                              | 7                                          | -                  |
| Purchases of short term investments                                                        | -                                          | (62,860)           |
| Proceeds from sales of short term investments                                              | -                                          | 62,860             |
| Net cash used in investing activities                                                      | (33,709)                                   | (26,362)           |
| <b>Cash flows from financing activities</b>                                                |                                            |                    |
| Proceeds from revolving credit facility                                                    | 30,000                                     | 14,000             |
| Payments on revolving credit facility                                                      | (15,000)                                   | (4,000)            |
| Proceeds from long term debt                                                               | 13,214                                     | 1,117              |
| Payments on long term debt                                                                 | (4,626)                                    | (2,085)            |
| Payments on capital lease obligations                                                      | (355)                                      | (674)              |
| Excess tax benefits from stock-based compensation arrangements                             | 1,891                                      | 5,820              |
| Proceeds from exercise of stock options and other stock issuances                          | 1,557                                      | 2,613              |
| Net cash provided by financing activities                                                  | 26,681                                     | 16,791             |
| Effect of exchange rate changes on cash and cash equivalents                               | 39                                         | 289                |
| Net decrease in cash and cash equivalents                                                  | (436)                                      | (56,182)           |
| <b>Cash and cash equivalents</b>                                                           |                                            |                    |
| Beginning of period                                                                        | 40,588                                     | 70,655             |

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|               |    |        |    |        |
|---------------|----|--------|----|--------|
| End of period | \$ | 40,152 | \$ | 14,473 |
|---------------|----|--------|----|--------|

## Non-cash financing and investing activities

|                                                                 |    |   |    |       |
|-----------------------------------------------------------------|----|---|----|-------|
| Increase to long term liabilities due to the adoption of FIN 48 | \$ | - | \$ | 1,597 |
|-----------------------------------------------------------------|----|---|----|-------|

|                                                                |  |       |  |   |
|----------------------------------------------------------------|--|-------|--|---|
| Purchase of property and equipment through certain obligations |  | 1,769 |  | - |
|----------------------------------------------------------------|--|-------|--|---|

See accompanying notes.

**Table of Contents****Under Armour, Inc. and Subsidiaries****Notes to the Unaudited Consolidated Financial Statements****1. Description of the Business**

Under Armour, Inc. is a developer, marketer and distributor of branded performance apparel, footwear and accessories. These products are sold worldwide and worn by athletes at all levels, from youth to professional on playing fields around the globe, as well as by consumers with active lifestyles.

**2. Summary of Significant Accounting Policies***Basis of Presentation*

The accompanying consolidated financial statements include the accounts of Under Armour, Inc. and its wholly owned subsidiaries (the Company). All inter-company balances and transactions have been eliminated. The accompanying consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America.

*Interim Financial Data*

The results for the three and nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the year ending December 31, 2008 or any other portions thereof. Certain information in footnote disclosures normally included in annual financial statements has been condensed or omitted for the interim periods presented in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC) for interim consolidated financial statements.

These financial statements do not contain all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments, consisting of normal, recurring adjustments considered necessary for a fair presentation of the financial position and results of operations have been included.

The consolidated balance sheet as of December 31, 2007 is derived from the audited financial statements included in the Company's Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2007 (the 2007 Form 10-K), which should be read in conjunction with these consolidated financial statements.

*Concentration of Credit Risk*

Financial instruments that subject the Company to significant concentration of credit risk consist primarily of accounts receivable. The majority of the Company's accounts receivable is due from large sporting goods retailers. Credit is extended based on an evaluation of the customer's financial condition and collateral is not required. The most significant customers that accounted for a large portion of net revenues and accounts receivable are as follows:

|                                      | <b>Customer<br/>A</b> | <b>Customer<br/>B</b> | <b>Customer<br/>C</b> |
|--------------------------------------|-----------------------|-----------------------|-----------------------|
| Net revenues                         |                       |                       |                       |
| Nine months ended September 30, 2008 | 20.0%                 | 13.8%                 | 4.3%                  |
| Nine months ended September 30, 2007 | 19.5%                 | 13.2%                 | 4.6%                  |
| Accounts receivable                  |                       |                       |                       |
| As of September 30, 2008             | 26.5%                 | 14.1%                 | 4.1%                  |
| As of September 30, 2007             | 23.7%                 | 13.5%                 | 4.6%                  |

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### *Income Taxes*

The Company recorded \$19.1 million and \$14.5 million of income tax expense for the three months ended September 30, 2008 and 2007, respectively, and \$22.1 million and \$25.2 million of income tax expense for the nine months ended September 30, 2008 and 2007, respectively. The effective rate for income taxes was 42.5% and 41.4% for the nine months ended September 30, 2008 and 2007, respectively. The Company's annual 2008 effective tax rate is expected to be 42.7% compared to the 2007 annual effective tax rate of 41.0%. The increase in the 2008 full year effective tax rate is primarily attributable to an increase in the state income tax rate in Maryland, where the Company's corporate headquarters is located.

### *Shipping and Handling Costs*

The Company charges certain customers shipping and handling fees. These fees are recorded in net revenues. The Company includes the majority of outbound shipping and handling costs as a component of selling, general and administrative expenses. Outbound shipping and handling costs include costs associated with shipping goods to customers and certain costs to operate the Company's distribution facilities. These costs, included within selling, general and administrative expenses, were \$5.0 million and \$4.4 million for the three months ended September 30, 2008 and 2007, respectively, and \$12.5 million and \$9.7 million for the nine months ended September 30, 2008 and 2007, respectively.

### *Other Employee Benefits*

Effective June 1, 2007, the Company's Board of Directors approved the Under Armour, Inc. Deferred Compensation Plan (the "Plan"). The Plan allows a select group of management or highly compensated employees, as approved by the Compensation Committee, to make an annual base salary and/or bonus deferral for each year. Compensation deferrals began for participating employees on January 1, 2008. As of September 30, 2008, the Plan obligation was \$2.6 million and was included in other long term liabilities on the consolidated balance sheet.

The Company established a rabbi trust (the "Rabbi Trust") during the three months ended March 31, 2008, to fund obligations to participants in the Plan. As of September 30, 2008, the assets held in the Rabbi Trust were trust owned life insurance policies ("TOLI") with a cash-surrender value of \$2.6 million. These assets are consolidated in accordance with Emerging Issues Task Force ("EITF") 97-14, *Accounting for Deferred Compensation Agreements Where Amounts Earned Are Held in a Rabbi Trust and Invested*, and are included in other non-current assets on the consolidated balance sheet. Refer to Note 7 for a discussion of the fair value measurements of the assets held in the Rabbi Trust and the Plan obligations.

### *Management Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates, including estimates relating to assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

### *Recently Adopted Accounting Standards*

In December 2007, the SEC issued Staff Accounting Bulletin ("SAB") No. 110, *Share-Based Payment* ("SAB 110"). SAB 110 amends SAB No. 107, *Share-Based Payment*, and allows for the continued use, under certain circumstances, of the "simplified method" in developing an estimate of the expected term on stock options accounted for under the Statement of Accounting Standards ("SFAS") No. 123R, *Share-Based Payment (revised 2004)*. SAB 110 is effective for stock options granted after December 31, 2007. The Company continued to use the "simplified method" in developing an estimate of the expected term on stock options granted in the first nine months of 2008. The Company does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term due to the limited period of time its shares of Class A Common Stock have been publicly traded.

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In February 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis. The Company adopted SFAS 159 in the first quarter of 2008 and did not choose to apply fair value accounting to any such assets or liabilities.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 was effective for fiscal years beginning after November 15, 2007, however the FASB has delayed the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities, except those items recognized or disclosed at fair value on an annual or more frequent basis. The adoption of SFAS 157 for financial assets and liabilities in the first quarter of 2008 did not have a material impact on the Company's consolidated financial statements. The Company does not believe that the adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities will have a material impact on its consolidated financial statements.

### *Recently Issued Accounting Standards*

In June 2008, the FASB issued FASB Staff Position ( FSP ) EITF No. 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* ( FSP EITF 03-6-1 ). FSP EITF 03-6-1 requires that unvested stock-based compensation awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) should be classified as participating securities and should be included in the computation of earnings per share pursuant to the two-class method as described by SFAS No. 128, *Earnings per Share*. The provisions of FSP EITF 03-6-1 are required for fiscal years beginning after December 15, 2008. The Company does not believe the adoption of FSP EITF 03-6-1 will have a material impact on its computation of earnings per share.

In June 2008, the FASB issued EITF Issue No. 07-5, *Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity's Own Stock* ( EITF 07-5 ). EITF 07-5 addresses the determination of whether provisions that introduce adjustment features (including contingent adjustment features) would prevent treating a derivative contract or an embedded derivative on a company's own stock as indexed solely to the company's stock. EITF 07-5 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact of adopting EITF 07-5 on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ( SFAS 161 ). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. The provisions of SFAS 161 are effective for the fiscal years and interim periods beginning after November 15, 2008. The Company does not believe the adoption of SFAS 161 will have a material impact on its consolidated financial statement disclosures.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations (revised 2007)* ( SFAS 141R ). SFAS 141R replaces SFAS 141 and requires the acquirer of a business to recognize and measure the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at fair value. SFAS 141R also requires transaction costs related to the business combination to be expensed as incurred. SFAS 141R is effective for business combinations for which the acquisition date is on or after fiscal years beginning after December 15, 2008. The Company does not believe the adoption of SFAS 141R will have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51* ( SFAS 160 ). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is

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effective for fiscal years beginning after December 15, 2008. The Company does not believe the adoption of SFAS 160 will have a material impact on its consolidated financial statements.

**3. Inventories**

Inventories consisted of the following:

| <i>(In thousands)</i> | September 30,<br>2008 | December 31,<br>2007 |
|-----------------------|-----------------------|----------------------|
| Finished goods        | \$ 167,801            | \$ 169,560           |
| Raw materials         | 784                   | 1,180                |
| Work-in-process       | 8                     | 208                  |
| Subtotal inventories  | 168,593               | 170,948              |
| Inventories reserve   | (4,981)               | (4,866)              |
| Total inventories     | \$ 163,612            | \$ 166,082           |

**4. Intangible Assets, Net**

The following table summarizes the Company's intangible assets as of the periods indicated:

| <i>(In thousands)</i>                      | September 30, 2008          |                             |                        | December 31, 2007           |                             |                        |
|--------------------------------------------|-----------------------------|-----------------------------|------------------------|-----------------------------|-----------------------------|------------------------|
|                                            | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Amount |
| Intangible assets subject to amortization: |                             |                             |                        |                             |                             |                        |
| Footwear promotional rights                | \$ 8,500                    | \$ (3,250)                  | \$ 5,250               | \$ 8,500                    | \$ (2,125)                  | \$ 6,375               |
| Other                                      | 725                         | (98)                        | 627                    | 125                         | (30)                        | 95                     |
| Total                                      | \$ 9,225                    | \$ (3,348)                  | \$ 5,877               | \$ 8,625                    | \$ (2,155)                  | \$ 6,470               |

Intangible assets are amortized using estimated useful lives of 33 months to 89 months with no residual value. Amortization expense, which is primarily included in selling, general and administrative expenses, was \$0.4 million for each of the three months ended September 30, 2008 and 2007, and \$1.2 million and \$1.1 million for the nine months ended September 30, 2008 and 2007, respectively. The estimated amortization expense of the Company's intangible assets is \$1.6 million for each of the years ending December 31, 2008 through 2011, and \$0.5 million for the year ending December 31, 2012.

**5. Revolving Credit Facility and Long Term Debt***Revolving Credit Facility*

In December 2006, the Company entered into a third amended and restated financing agreement with a lending institution. This financing agreement has a term of five years and provides for a committed revolving credit line of up to \$100.0 million based on the Company's eligible domestic inventory and accounts receivable balances and may be used for working capital and general corporate purposes. This financing agreement is collateralized by substantially all of the Company's domestic assets, other than its trademarks. Up to \$10.0 million of the facility may be used to support letters of credit, which if utilized would reduce the availability under the revolving credit facility.

If net availability under the financing agreement falls below a certain threshold as defined in the agreement, the Company would be required to maintain a maximum leverage ratio of 1.25 and a minimum fixed charge coverage ratio of 1.10 to 1.25 as defined in the agreement. This financing agreement also provides the lenders



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with the ability to reduce the available revolving credit line amount even if the Company is in compliance with all conditions of the agreement, based on negative forecasts, trends or other circumstances that the lenders reasonably determine could negatively impact the Company or its business, profits, operations, financial condition or assets. The Company's net availability as of September 30, 2008 was well above the threshold for compliance with the financial covenants and the Company was substantially below the maximum leverage ratio and substantially above the minimum fixed charge coverage ratio as of September 30, 2008.

As of September 30, 2008, \$15.0 million was outstanding under the revolving credit facility, and the Company's net availability was \$85.0 million based on its eligible domestic inventory and accounts receivable balances. The weighted average interest rate on the balances outstanding under the revolving credit facility was 3.5% and 6.8% for the three months ended September 30, 2008 and 2007, respectively, and 3.5% and 6.8% for the nine months ended September 30, 2008 and 2007, respectively.

*Long Term Debt*

In March 2005, the Company entered into an agreement to finance the acquisition or lease of up to \$17.0 million in qualifying capital investments. Loans under this agreement are collateralized by a first lien on the assets acquired. The agreement is not a committed facility, with each advance under the agreement subject to the lender's approval. In March 2008, the lender agreed to increase the maximum financing under the agreement to \$37.0 million.

In May 2008, the Company entered into an additional agreement to finance the acquisition or lease of up to \$40.0 million in qualifying capital investments. Loans under this additional agreement are collateralized by a first lien on the assets acquired. This additional agreement is not a committed facility, with each advance under the agreement subject to the lender's approval.

These agreements include a cross default provision whereby an event of default under other debt obligations, including the revolving credit facility agreement, is considered an event of default under these agreements. As of September 30, 2008 and December 31, 2007, the outstanding principal balance was \$22.0 million and \$13.4 million, respectively, under these agreements. Currently, advances under these agreements bear interest rates which are fixed at the time of each advance. The weighted average interest rate on outstanding borrowings was 5.9% and 6.6% for the three months ended September 30, 2008 and 2007, respectively, and 6.1% and 6.6% for the nine months ended September 30, 2008 and 2007, respectively.

The following is a schedule of future principal and interest payments on long term debt as of September 30, 2008:

*(In thousands)*

|                                            |    |         |
|--------------------------------------------|----|---------|
| October 1 - December 31, 2008              | \$ | 2,171   |
| 2009                                       |    | 8,041   |
| 2010                                       |    | 7,872   |
| 2011                                       |    | 3,742   |
| 2012 and thereafter                        |    | 2,326   |
| Total future payments on long term debt    |    | 24,152  |
| Less amount representing interest          |    | (2,155) |
| Total principal payments on long term debt |    | 21,997  |
| Less current maturities of long term debt  |    | (7,192) |
| Long term debt obligations                 | \$ | 14,805  |

The Company monitors the financial health and stability of its lenders under the revolving credit and long term debt facilities, however current significant instability in the credit markets could negatively impact lenders and their ability to perform under their facilities.



**Table of Contents****6. Commitments and Contingencies***Sponsorships and Other Marketing Commitments*

Within the normal course of business, the Company enters into contractual commitments in order to promote the Company's brand and products. These commitments include sponsorship agreements with teams and athletes on the collegiate and professional levels, official supplier agreements, athletic event sponsorships and other marketing commitments. The following is a schedule of the Company's future minimum payments under its sponsorship and other marketing agreements as of September 30, 2008:

*(In thousands)*

|                               |    |        |
|-------------------------------|----|--------|
| October 1 - December 31, 2008 | \$ | 3,699  |
| 2009                          |    | 22,408 |
| 2010                          |    | 19,873 |
| 2011                          |    | 16,212 |
| 2012 and thereafter           |    | 7,715  |

|                                                               |    |        |
|---------------------------------------------------------------|----|--------|
| Total future minimum sponsorship and other marketing payments | \$ | 69,907 |
|---------------------------------------------------------------|----|--------|

The amounts listed above are the minimum obligations required to be paid under the Company's sponsorship and other marketing agreements. The amounts listed above do not include additional incentives based on performance achievements while wearing or using the Company's products and product supply obligations provided under some of these agreements.

*Other*

The Company is, from time to time, involved in routine legal matters incidental to its business. Management believes that the ultimate resolution of any such current proceedings and claims will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

In connection with various contracts and agreements, the Company has agreed to indemnify counterparties against certain third party claims relating to the infringement of intellectual property rights and other items that fall under the scope of Financial Accounting Standards Board (FASB) Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. Based on the Company's historical experience and the estimated probability of future loss, the Company has determined that the fair value of such indemnifications is not material to its consolidated financial position or results of operations.

Certain key executives are party to agreements with the Company that include severance benefits upon involuntary termination of employment without cause or for good reason, including following a change in control of the Company.

**7. Fair Value Measurements**

The Company adopted SFAS 157 as of January 1, 2008 for its financial assets and liabilities. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). SFAS 157 outlines a valuation framework and creates a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and the related disclosures and prioritizes the inputs used in measuring fair value as follows:

Level 1: Observable inputs such as quoted prices in active markets;

Level 2: Inputs, other than quoted prices in active markets, that are observable either directly or indirectly; and

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Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Financial assets and (liabilities) measured at fair value as of September 30, 2008 are set forth in the table below:

| <i>(In thousands)</i> | Description                                                 | Level 1 | Level 2 | Level 3 |
|-----------------------|-------------------------------------------------------------|---------|---------|---------|
|                       | Derivative foreign currency forward contracts (see Note 10) | \$ -    | \$ 516  | \$ -    |
|                       | TOLI held by the Rabbi Trust (see Note 2)                   | -       | 2,620   | -       |
|                       | The Plan obligations (see Note 2)                           | -       | (2,586) | -       |

Fair values of the financial assets and liabilities listed above are determined using inputs that use as their basis readily observable market data that are actively quoted and are validated through external sources, including third-party pricing services and brokers. The foreign currency forward contracts represent gains and losses on derivative contracts, which is the net difference between the U.S. dollars to be received or paid at the contracts' settlement date and the U.S. dollar value of the foreign currency to be sold or purchased at the current forward exchange rate. The fair value of the TOLI held by the Rabbi Trust is based on the cash-surrender value of the policies, which are invested primarily in mutual funds and a separately managed fixed income fund. These investments are in the same funds and purchased in substantially the same amounts as the participants' selected investments, which represent the underlying liabilities to participants in the Plan. Liabilities under the Plan are recorded at amounts due to participants, based on the fair value of participants' selected investments.

## 8. Other Income (Expense), Net

The components of other income (expense), net consisted of the following:

| <i>(In thousands)</i>                                    | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|----------------------------------------------------------|-------------------------------------|--------|------------------------------------|----------|
|                                                          | 2008                                | 2007   | 2008                               | 2007     |
| Interest income                                          | \$ 84                               | \$ 106 | \$ 358                             | \$ 1,354 |
| Interest expense                                         | (195)                               | (207)  | (856)                              | (532)    |
| Unrealized foreign currency exchange rate gains (losses) | (1,697)                             | 1,329  | (1,517)                            | 2,321    |
| Realized foreign currency exchange rate gains (losses)   | (490)                               | 71     | (882)                              | 350      |
| Unrealized derivative gains (losses)                     | 403                                 | (550)  | 750                                | (550)    |
| Realized derivative gains (losses)                       | 140                                 | (75)   | 116                                | (75)     |
| Other                                                    | 19                                  | -      | 19                                 | -        |
| Total other income (expense), net                        | \$ (1,736)                          | \$ 674 | \$ (2,012)                         | \$ 2,868 |

## 9. Stock-Based Compensation

In July 2008, the Company hired a new President. Upon his hiring, 138.3 thousand shares of restricted stock and 185.8 thousand performance-based stock options were awarded to him under the Company's 2005 Omnibus Long-Term Incentive Plan. The shares of restricted stock vest 50% approximately one year from the grant date, 25% approximately two years from the grant date, and 12.5% approximately three and four years from the grant date. If the President's employment is terminated without cause within two years of the grant date, any shares of restricted stock that would have vested within twelve months of the termination date will vest on that date. The performance-based stock options have a term of ten years from the grant date and vest in four equal installments subject to the achievement of four separate annual operating income targets. Upon the achievement of each of the

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first three annual operating income targets, 50% of each tranche will vest and the remaining 50% of each tranche will vest one year later. When the fourth annual operating income target is achieved, 100% of that tranche will vest. If an annual operating income target is not achieved by a certain date, the portion of the award tied to that performance level will be forfeited.

The exercise price of the stock options and the fair value of each share of restricted stock was \$28.93, which was the closing price of the Company's Class A Common Stock on the date of grant. The weighted average fair value of each of the performance-based stock options was \$16.16 and was estimated using the Black-Scholes option-pricing model consistent with the weighted average assumptions included in the 2007 Form 10-K. As of September 30, 2008, the Company has not recorded stock-based compensation expense for the performance-based stock options as the Company is unable to predict with certainty whether the annual operating income targets will be reached. The Company will assess the probability of the achievement of each annual operating income target at the end of each reporting period. When it becomes probable that a performance target will be achieved, a cumulative adjustment will be recorded as if ratable stock-based compensation expense had been recorded since the grant date.

In February 2008, 357.6 thousand stock options and 139.0 thousand shares of restricted stock and restricted stock units were awarded to certain officers and key employees under the Company's 2005 Omnibus Long-Term Incentive Plan. These awards vest ratably over a five year period, and the stock options have a term of ten years from the date of grant. The exercise price of the stock options and the fair value of each share of restricted stock and restricted stock unit was \$43.65, which was the closing price of the Company's Class A Common Stock on the date of grant. The fair value of each of these stock options was \$21.84 and was estimated using the Black-Scholes option-pricing model consistent with the weighted average assumptions included in the 2007 Form 10-K.

As permitted by SAB 110, the Company used the simplified method to calculate the expected term for stock options granted during the nine months ended September 30, 2008 since it does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term due to the limited period of time its shares of Class A Common Stock have been publicly traded.

## **10. Foreign Currency Risk Management and Derivatives**

The Company is exposed to gains and losses resulting from fluctuations in foreign currency exchange rates primarily relating to transactions generated by its international subsidiaries in currencies other than their local currencies. In August 2007, the Company began using foreign currency forward contracts in order to reduce the risk associated with foreign currency exchange rate fluctuations on projected inventory purchases, inter-company transactions and other general working capital requirements for its Canadian subsidiary.

As of September 30, 2008, the notional value of the Company's outstanding foreign currency forward contracts used to mitigate the foreign currency exchange rate fluctuations on its Canadian subsidiary's projected inventory purchases and inter-company transactions was approximately \$15.9 million with contract maturities of 1 to 9 months. The foreign currency forward contracts are not designated as cash flow hedges, and accordingly, changes in their fair value are recorded in earnings. As of September 30, 2008, the fair value of the Company's foreign currency forward contracts was \$0.5 million which is included in prepaid expenses and other current assets on the consolidated balance sheet. Refer to Note 7 for a discussion of the fair value measurements and refer to Note 8 for a summary of the realized and unrealized gains and losses of the Company's foreign currency forward contracts.

The Company enters into foreign currency forward contracts with a major financial institution with investment grade credit ratings and is exposed to credit losses in the event of non-performance by this financial institution. This credit risk is generally limited to the unrealized gains in the foreign currency forward contracts. However, the Company monitors the credit quality of the financial institution and considers the risk of counterparty default to be minimal.

**Table of Contents****11. Earnings per Share**

The following represents a reconciliation from basic earnings per share to diluted earnings per share:

| <i>(In thousands, except per share amounts)</i>                    | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--------------------------------------------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                                                                    | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                                | <b>2007</b> |
| <b>Numerator</b>                                                   |                                             |             |                                            |             |
| Net income                                                         | \$ 25,663                                   | \$ 20,030   | \$ 29,908                                  | \$ 35,683   |
| <b>Denominator</b>                                                 |                                             |             |                                            |             |
| Weighted average common shares outstanding                         | 48,647                                      | 48,183      | 48,529                                     | 47,926      |
| Effect of dilutive securities                                      | 1,287                                       | 1,902       | 1,379                                      | 2,003       |
| Weighted average common shares and dilutive securities outstanding | 49,934                                      | 50,085      | 49,908                                     | 49,929      |
| Earnings per share - basic                                         | \$ 0.53                                     | \$ 0.42     | \$ 0.62                                    | \$ 0.74     |
| Earnings per share - diluted                                       | \$ 0.51                                     | \$ 0.40     | \$ 0.60                                    | \$ 0.71     |

Effects of potentially dilutive securities are presented only in periods in which they are dilutive. Stock options, restricted stock awards, restricted stock units and warrants representing 1.5 million and 72.0 thousand shares of common stock were outstanding for the three months ended September 30, 2008 and 2007, respectively, and stock options, restricted stock awards, restricted stock units and warrants representing 1.2 million and 125.3 thousand shares of common stock were outstanding for the nine months ended September 30, 2008 and 2007, respectively, but were excluded from the computation of diluted earnings per share because their effect would be anti-dilutive.

**12. Related Party Transactions**

In 2007, the Company entered into an operating lease agreement with an entity controlled by the Company's Chief Executive Officer to lease an aircraft for business purposes. During the nine months ended September 30, 2008, the Company paid \$0.3 million in usage fees to this entity for the Company's business use of the aircraft. No amounts were paid to this entity during the nine months ended September 30, 2007. Amounts payable to this related party as of September 30, 2008 and 2007 were \$0.1 million and \$0.3 million, respectively. The Company determined the usage fees charged are at or below market. From time to time, the Company utilizes the aircraft for business use at no charge. During the nine months ended September 30, 2008, the Company was not charged approximately \$0.2 million for business use of the aircraft. The Company was charged for substantially all business use of the aircraft during the nine months ended September 30, 2007.

**Table of Contents****13. Segment Data and Related Information**

Operating segments are defined as components of an enterprise in which separate financial information is available and is evaluated regularly by the chief operating decision maker in assessing performance and in deciding how to allocate resources. The Company operates exclusively in the consumer products industry in which the Company develops, markets, and distributes branded performance apparel, footwear and accessories. Based on the nature of the financial information that is received by the chief operating decision maker, the Company operates within one operating and reportable segment in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. Although the Company operates within one reportable segment, it has several product categories for which the net revenues attributable to each product category are as follows:

| (In thousands)     | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--------------------|-------------------------------------|------------|------------------------------------|------------|
|                    | 2008                                | 2007       | 2008                               | 2007       |
| Men's              | \$ 131,956                          | \$ 112,950 | \$ 279,105                         | \$ 242,429 |
| Women's            | 50,311                              | 39,467     | 105,093                            | 82,661     |
| Youth              | 18,818                              | 16,603     | 42,282                             | 34,821     |
| Total apparel      | 201,085                             | 169,020    | 426,480                            | 359,911    |
| Footwear           | 13,065                              | 2,158      | 75,629                             | 34,086     |
| Accessories        | 8,896                               | 7,638      | 22,264                             | 20,010     |
| Total net sales    | 223,046                             | 178,816    | 524,373                            | 414,007    |
| License revenues   | 8,900                               | 8,047      | 21,592                             | 17,716     |
| Total net revenues | \$ 231,946                          | \$ 186,863 | \$ 545,965                         | \$ 431,723 |

The table below summarizes product net revenues by geographic regions attributed by customer location:

| (In thousands)          | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|-------------------------|-------------------------------------|------------|------------------------------------|------------|
|                         | 2008                                | 2007       | 2008                               | 2007       |
| United States           | \$ 210,546                          | \$ 172,206 | \$ 500,817                         | \$ 400,639 |
| Canada                  | 12,677                              | 8,449      | 26,836                             | 17,867     |
| Subtotal                | 223,223                             | 180,655    | 527,653                            | 418,506    |
| Other foreign countries | 8,723                               | 6,208      | 18,312                             | 13,217     |
| Total net revenues      | \$ 231,946                          | \$ 186,863 | \$ 545,965                         | \$ 431,723 |

During the nine months ended September 30, 2008 and 2007, substantially all of the Company's long-lived assets were located in the United States.

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

#### **Forward-Looking Statements**

Some of the statements contained in this Form 10-Q and any documents that may be incorporated herein by reference constitute forward-looking statements. Forward-looking statements relate to expectations, beliefs, projections, future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts, such as statements regarding our future financial condition or results of operations, our prospects and strategies for future growth, the development and introduction of new products, and the implementation of our marketing and branding strategies. In many cases, you can identify forward-looking statements by terms such as may, will, should, expects, plans, anticipates, believes, intends, estimates, predicts, potential or the negative of these terms or other comparable terminology.

The forward-looking statements contained in this Form 10-Q and any documents that may be incorporated herein by reference reflect our current views about future events and are subject to risks, uncertainties, assumptions and changes in circumstances that may cause events or our actual activities or results to differ significantly from those expressed in any forward-looking statement. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future events, results, actions, levels of activity, performance or achievements. Readers are cautioned not to place undue reliance on these forward-looking statements. A number of important factors could cause actual results to differ materially from those indicated by the forward-looking statements, including, but not limited to, those factors described in our Annual Report on Form 10-K filed with the Securities and Exchange Commission ( SEC ) (our 2007 Form 10-K ) or in this Form 10-Q, if included herein, under Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ). These factors include without limitation:

our ability to forecast and manage our growth effectively;

our ability to effectively develop and launch new and updated products;

our ability to accurately forecast consumer demand for our products;

changes in general economic or market conditions that could affect consumer spending and the general health of our retail customers;

our ability to obtain the financing required to grow our business, particularly when credit and capital markets are unstable;

increased competition causing us to reduce the prices of our products or to increase significantly our marketing efforts in order to avoid losing market share;

changes in consumer preferences or the reduction in demand for performance apparel and other products;

reduced demand for sporting goods and apparel generally;

failure of our suppliers or manufacturers to produce or deliver our products in a timely or cost-effective manner;

our ability to accurately anticipate and respond to seasonal or quarterly fluctuations in our operating results;

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our ability to effectively market and maintain a positive brand image;

the availability, integration and effective operation of management information systems and other technology;

our ability to attract and maintain the services of our senior management and key employees; and

our ability to maintain effective internal controls.

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The forward-looking statements contained in this Form 10-Q reflect our views and assumptions only as of the date of this Form 10-Q. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

### **Overview**

We are a leading developer, marketer and distributor of branded performance apparel, footwear and accessories. The brand's moisture-wicking synthetic fabrications are engineered in many different designs and styles for wear in nearly every climate to provide a performance alternative to traditional natural fiber products. Our products are sold worldwide and worn by athletes at all levels, from youth to professional, on playing fields around the globe, as well as by consumers with active lifestyles.

Our net revenues grew to \$606.6 million in 2007 from \$115.4 million in 2003. We reported net revenues of \$546.0 million for the first nine months of 2008, which represented a 26.5% increase from the first nine months of 2007. We believe that our growth in net revenues has been driven by a growing interest in performance products and the strength of the Under Armour brand in the marketplace relative to our competitors, as evidenced by the increases in sales of our men's, women's and youth apparel, footwear and accessories. We plan to continue to increase our net revenues by building upon our relationships with existing customers, expanding our product offerings, offering new products, building our direct to consumer sales channel and building our brand internationally. Our direct to consumer channel includes sales through our website, catalog and retail outlet and specialty stores. New product offerings included the May 2008 introduction of performance training footwear, which we began shipping in the first quarter of 2008, and will include running footwear to be introduced in the first quarter of 2009. In addition, we have entered into strategic agreements with third party licensees and distributors to further reinforce our brand identity and increase our net revenues.

Our products are currently offered in approximately 17,000 retail stores worldwide. A large majority of our products are sold in North America; however we believe that our products appeal to athletes and consumers with active lifestyles around the globe. Internationally, our products are offered primarily in the United Kingdom, France and Germany, as well as in Japan through a third-party licensee, and through our distributors located in other foreign countries.

### **General**

Net revenues comprise both net sales and license revenues. Net sales comprise our five primary product categories, which are men's, women's and youth apparel, footwear and accessories. Our license revenues consist of fees paid to us by our licensees in exchange for the use of our trademarks on core products of socks, hats, bags, eyewear and other accessories, as well as the distribution of our products in Japan.

Cost of goods sold consists primarily of product costs, inbound freight and duty costs, handling costs to make products floor-ready to customer specifications, and write downs for inventory obsolescence. The fabrics in our products are made of petroleum-based synthetic materials. Therefore our product costs, as well as our inbound freight costs, could be affected by long term pricing trends of oil. In addition, cost of goods sold includes overhead costs associated with our Special Make-Up Shop located at one of our distribution facilities where we manufacture a limited number of products, and costs relating to our Hong Kong and Guangzhou, China offices which help support manufacturing, quality assurance and sourcing efforts. No cost of goods sold is associated with license revenues.

We include a majority of our outbound shipping and handling costs as a component of selling, general and administrative expenses. As a result, our gross profit may not be comparable to that of other companies that include outbound shipping and handling costs in the calculation of their cost of goods sold. Outbound shipping and handling costs include costs associated with shipping goods to customers and certain costs to operate our



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distribution facilities. These costs were \$5.0 million and \$4.4 million for the three months ended September 30, 2008 and 2007, respectively, and \$12.5 million and \$9.7 million for the nine months ended September 30, 2008 and 2007, respectively.

Our selling, general and administrative expenses consist of costs related to marketing, selling, product innovation and supply chain and corporate services. Our marketing costs are an important driver of our growth. Historically, our marketing investments were within the range of 10% to 12% of net revenues. For the full year 2008, we expect to invest in marketing at the high-end of the range of 12% to 13% of net revenues. Marketing costs consist primarily of commercials, print ads, league, team and player sponsorships, amortization of footwear promotional rights, depreciation expense specific to our in-store fixture program and marketing related payroll. Selling costs consist primarily of payroll and other costs relating to sales through our wholesale and direct to consumer sales channels, along with commissions paid to third parties. Product innovation and supply chain costs include our apparel and footwear product creation and development costs, distribution facility operating costs, and related payroll. Corporate services primarily consist of corporate facility operating costs, related payroll and company-wide administrative and stock-based compensation expenses.

Other income (expense), net consists of interest income, interest expense, unrealized and realized gains and losses on our derivative financial instruments, and unrealized and realized gains and losses on adjustments that arise from fluctuations in foreign currency exchange rates relating to transactions generated by our international subsidiaries.

**Results of Operations**

The following table sets forth key components of our results of operations for the periods indicated, both in dollars and as a percentage of net revenues:

| <i>(In thousands)</i>                        | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|----------------------------------------------|-------------------------------------|------------|------------------------------------|------------|
|                                              | 2008                                | 2007       | 2008                               | 2007       |
| Net revenues                                 | \$ 231,946                          | \$ 186,863 | \$ 545,965                         | \$ 431,723 |
| Cost of goods sold                           | 113,679                             | 92,346     | 281,959                            | 217,526    |
| Gross profit                                 | 118,267                             | 94,517     | 264,006                            | 214,197    |
| Selling, general and administrative expenses | 71,788                              | 60,708     | 209,954                            | 156,186    |
| Income from operations                       | 46,479                              | 33,809     | 54,052                             | 58,011     |
| Other income (expense), net                  | (1,736)                             | 674        | (2,012)                            | 2,868      |
| Income before income taxes                   | 44,743                              | 34,483     | 52,040                             | 60,879     |
| Provision for income taxes                   | 19,080                              | 14,453     | 22,132                             | 25,196     |
| Net income                                   | \$ 25,663                           | \$ 20,030  | \$ 29,908                          | \$ 35,683  |

| <i>(As a percentage of net revenues)</i>     | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|----------------------------------------------|-------------------------------------|--------|------------------------------------|--------|
|                                              | 2008                                | 2007   | 2008                               | 2007   |
| Net revenues                                 | 100.0%                              | 100.0% | 100.0%                             | 100.0% |
| Cost of goods sold                           | 49.0                                | 49.4   | 51.6                               | 50.4   |
| Gross profit                                 | 51.0                                | 50.6   | 48.4                               | 49.6   |
| Selling, general and administrative expenses | 31.0                                | 32.5   | 38.5                               | 36.2   |
| Income from operations                       | 20.0                                | 18.1   | 9.9                                | 13.4   |
| Other income (expense), net                  | (0.7)                               | 0.4    | (0.4)                              | 0.7    |
| Income before income taxes                   | 19.3                                | 18.5   | 9.5                                | 14.1   |

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|                            |       |       |      |      |
|----------------------------|-------|-------|------|------|
| Provision for income taxes | 8.2   | 7.8   | 4.0  | 5.8  |
| Net income                 | 11.1% | 10.7% | 5.5% | 8.3% |

**Table of Contents****Three Months Ended September 30, 2008 Compared to Three Months Ended September 30, 2007**

*Net revenues* increased \$45.0 million, or 24.1%, to \$231.9 million for the three months ended September 30, 2008 from \$186.9 million for the same period in 2007. This increase was primarily the result of an increase in our net sales as noted in the product category table below:

|                       | 2008       | Three Months Ended September 30,<br>2007 | \$ Change | % Change |
|-----------------------|------------|------------------------------------------|-----------|----------|
| <i>(In thousands)</i> |            |                                          |           |          |
| Men's                 | \$ 131,956 | \$ 112,950                               | \$ 19,006 | 16.8%    |
| Women's               | 50,311     | 39,467                                   | 10,844    | 27.5     |
| Youth                 | 18,818     | 16,603                                   | 2,215     | 13.3     |
| Total apparel         | 201,085    | 169,020                                  | 32,065    | 19.0     |
| Footwear              | 13,065     | 2,158                                    | 10,907    | 505.4    |
| Accessories           | 8,896      | 7,638                                    | 1,258     | 16.5     |
| Total net sales       | 223,046    | 178,816                                  | 44,230    | 24.7     |
| License revenues      | 8,900      | 8,047                                    | 853       | 10.6     |
| Total net revenues    | \$ 231,946 | \$ 186,863                               | \$ 45,083 | 24.1%    |

*Net sales* increased \$44.2 million, or 24.7%, to \$223.0 million for the three months ended September 30, 2008 from \$178.8 million during the same period in 2007 as noted in the table above. The increase in net sales primarily reflects:

\$10.9 million increase in footwear sales driven primarily by our performance trainer footwear launched in the second quarter of 2008;

continued unit volume growth in certain existing apparel products, such as training, basketball and mountain products;

increased average apparel selling prices driven primarily by a higher percentage of direct to consumer sales in the current year period versus the prior year period; and

product introductions subsequent to September 30, 2007 in multiple product categories, most significantly in our training and compression categories.

*License revenues* increased \$0.9 million, or 10.6%, to \$8.9 million for the three months ended September 30, 2008 from \$8.0 million during the same period in 2007. This increase in license revenues was a result of increased sales by our licensees due to increased distribution and continued unit volume growth, along with new product offerings.

*Gross profit* increased \$23.8 million to \$118.3 million for the three months ended September 30, 2008 from \$94.5 million for the same period in 2007. Gross profit as a percentage of net revenues, or gross margin, increased 40 basis points to 51.0% for the three months ended September 30, 2008 compared to 50.6% during the same period in 2007. The increase in gross margin percentage was primarily driven by the following:

higher inventory reserves in the prior year period, primarily related to certain discontinued cleated footwear styles, along with improved sales returns and markdown allowances in the current year period, accounting for an approximate 120 basis point increase;

partially offset by

significantly higher sales of footwear year over year which have lower margins than our apparel products, accounting for an approximate 80 basis point decrease.

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*Selling, general and administrative expenses* increased \$11.1 million to \$71.8 million for the three months ended September 30, 2008 from \$60.7 million for the same period in 2007. As a percentage of net revenues, selling, general and administrative expenses decreased to 31.0% for the three months ended September 30, 2008 from 32.5% for the same period in 2007. These changes were primarily attributable to the following:

Marketing costs increased \$3.3 million to \$24.8 million for the three months ended September 30, 2008 from \$21.5 million for the same period in 2007 primarily due to our in-store brand marketing campaign, including marketing costs for specific customers, sponsorship of new teams on the collegiate and professional levels and increased personnel costs. These increases were partially offset by lower media expenditures in 2008. As a percentage of net revenues, marketing costs decreased to 10.7% for the three months ended September 30, 2008 from 11.5% for the same period in 2007 primarily due to lower media expenditures, partially offset by the other items noted above.

Selling costs increased \$2.9 million to \$13.8 million for the three months ended September 30, 2008 from \$10.9 million for the same period in 2007. This increase was primarily due to costs incurred for the continued expansion of our direct to consumer sales channel. As a percentage of net revenues, selling costs increased slightly to 5.9% for the three months ended September 30, 2008 from 5.8% for the same period in 2007 primarily due to costs incurred for the continued expansion of our direct to consumer sales channel, partially offset by lower personnel costs in 2008.

Product innovation and supply chain costs increased \$2.1 million to \$16.1 million for the three months ended September 30, 2008 from \$14.0 million for the same period in 2007 primarily due to higher distribution facilities operating costs to support our growth in net revenues and higher costs for the design of our expanding footwear and apparel lines. As a percentage of net revenues, product innovation and supply chain costs decreased to 6.9% for the three months ended September 30, 2008 from 7.5% for the same period in 2007 primarily due to lower personnel costs in 2008.

Corporate services costs increased \$2.8 million to \$17.1 million for the three months ended September 30, 2008 from \$14.3 million for the same period in 2007. This increase was attributable primarily to higher company-wide stock-based compensation, increased corporate costs relating to the expansion of our network of retail stores, and higher post-implementation consulting costs and depreciation expense related to our new warehouse management system. These increases were partially offset by lower corporate personnel costs in 2008. As a percentage of net revenues, corporate services costs decreased to 7.4% for the three months ended September 30, 2008 from 7.7% for the same period in 2007 primarily due to lower corporate personnel costs, partially offset by higher company-wide stock-based compensation in 2008.

*Income from operations* increased \$12.7 million, or 37.5%, to \$46.5 million for the three months ended September 30, 2008 from \$33.8 million for the same period in 2007. Income from operations as a percentage of net revenues increased to 20.0% for the three months ended September 30, 2008 from 18.1% for the same period in 2007. This increase was a result of a decrease in selling, general and administrative expenses and an increase in gross profit as a percentage of net revenues as discussed above.

*Other income (expense), net* decreased \$2.4 million to (\$1.7) million for the three months ended September 30, 2008 from \$0.7 million for the same period in 2007. This decrease was primarily due to unrealized and realized foreign currency exchange rate losses, partially offset by unrealized and realized derivative financial instrument gains for the three months ended September 30, 2008 as compared to unrealized and realized foreign currency exchange rate gains, partially offset by unrealized and realized derivative financial instrument losses for the same period in 2007.

*Provision for income taxes* increased \$4.6 million to \$19.1 million for the three months ended September 30, 2008 from \$14.5 million for the same period in 2007. For the three months ended September 30, 2008, our effective tax rate was 42.6% compared to 41.9% for the same period in 2007. Our annual 2008 effective tax rate is expected to be 42.7% compared to the 2007 annual effective tax rate of 41.0%. The increase

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in the 2008 full year effective tax rate is primarily attributable to an increase in the state income tax rate in Maryland, where our corporate headquarters is located.

*Net income* increased \$5.7 million to \$25.7 million for the three months ended September 30, 2008 from \$20.0 million for the same period in 2007, as a result of the factors described above.

**Nine Months Ended September 30, 2008 Compared to Nine Months Ended September 30, 2007**

*Net revenues* increased \$114.3 million, or 26.5%, to \$546.0 million for the nine months ended September 30, 2008 from \$431.7 million for the same period in 2007. This increase was the result of increases in both our net sales and license revenues as noted in the product category table below:

|                       | 2008       | Nine Months Ended September 30,<br>2007 | \$ Change  | % Change |
|-----------------------|------------|-----------------------------------------|------------|----------|
| <i>(In thousands)</i> |            |                                         |            |          |
| Men s                 | \$ 279,105 | \$ 242,429                              | \$ 36,676  | 15.1%    |
| Women s               | 105,093    | 82,661                                  | 22,432     | 27.1     |
| Youth                 | 42,282     | 34,821                                  | 7,461      | 21.4     |
| Total apparel         | 426,480    | 359,911                                 | 66,569     | 18.5     |
| Footwear              | 75,629     | 34,086                                  | 41,543     | 121.9    |
| Accessories           | 22,264     | 20,010                                  | 2,254      | 11.3     |
| Total net sales       | 524,373    | 414,007                                 | 110,366    | 26.7     |
| License revenues      | 21,592     | 17,716                                  | 3,876      | 21.9     |
| Total net revenues    | \$ 545,965 | \$ 431,723                              | \$ 114,242 | 26.5%    |

*Net sales* increased \$110.4 million, or 26.7%, to \$524.4 million for the nine months ended September 30, 2008 from \$414.0 million during the same period in 2007 as noted in the table above. The increase in net sales primarily reflects:

\$41.5 million, or 121.9%, increase in footwear sales driven primarily by our performance trainer footwear launched in the second quarter of 2008;

continued unit volume growth in certain existing apparel products, such as training, team, golf, basketball and mountain products;

increased average apparel selling prices driven primarily by a higher percentage of direct to consumer sales in the current year period versus the prior year period; and

product introductions subsequent to September 30, 2007 in multiple product categories, most significantly in our training, golf and basketball categories.

*License revenues* increased \$3.9 million, or 21.9%, to \$21.6 million for the nine months ended September 30, 2008 from \$17.7 million during the same period in 2007. This increase in license revenues was a result of increased sales by our licensees due to increased distribution and continued unit volume growth, along with new product offerings.

*Gross profit* increased \$49.8 million to \$264.0 million for the nine months ended September 30, 2008 from \$214.2 million for the same period in 2007. Gross profit as a percentage of net revenues, or gross margin, decreased 120 basis points to 48.4% for the nine months ended

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September 30, 2008 compared to 49.6% during the same period in 2007. The decrease in gross margin percentage was primarily driven by the following:

significantly higher sales of footwear year over year which have lower margins than our apparel products, accounting for an approximate 130 basis point decrease;

less favorable apparel product mix relative to margins, along with slightly higher product and inbound logistics costs, accounting for an approximate 45 basis point decrease; partially offset by

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higher inventory reserves in the prior year period, largely related to certain discontinued cleated footwear styles, along with improved sales returns and markdown allowances in the current year period, accounting for an approximate 30 basis point increase; and

increased sales through our direct to consumer sales channel which produces higher margins, along with increased license revenues, accounting for an approximate 25 basis point increase.

*Selling, general and administrative expenses* increased \$53.8 million to \$210.0 million for the nine months ended September 30, 2008 from \$156.2 million for the same period in 2007. As a percentage of net revenues, selling, general and administrative expenses increased to 38.5% for the nine months ended September 30, 2008 from 36.2% for the same period in 2007. These changes were primarily attributable to the following:

Marketing costs increased \$23.7 million to \$75.3 million for the nine months ended September 30, 2008 from \$51.6 million for the same period in 2007 primarily due to increased marketing costs for specific customers, sponsorship of new teams and athletes on the collegiate and professional levels, our film, print and in-store brand marketing campaign for the introduction of our performance training footwear and increased personnel costs. As a percentage of net revenues, marketing costs increased to 13.8% for the nine months ended September 30, 2008 from 12.0% for the same period in 2007 primarily due to the items noted above.

Selling costs increased \$9.5 million to \$39.0 million for the nine months ended September 30, 2008 from \$29.5 million for the same period in 2007. This increase was primarily due to costs incurred for the continued expansion of our direct to consumer sales channel, along with additional personnel in our domestic and international sales force. As a percentage of net revenues, selling costs increased to 7.1% for the nine months ended September 30, 2008 from 6.8% for the same period in 2007 due to the continued expansion of our direct to consumer sales channel, partially offset by lower personnel costs in 2008.

Product innovation and supply chain costs increased \$10.6 million to \$46.3 million for the nine months ended September 30, 2008 from \$35.7 million for the same period in 2007 primarily due to higher distribution facilities operating costs and additional personnel to support our growth in net revenues and additional personnel for the design and sourcing of our expanding footwear and apparel lines. As a percentage of net revenues, product innovation and supply chain costs increased to 8.5% for the nine months ended September 30, 2008 from 8.3% for the same period in 2007 primarily due to the items noted above.

Corporate services costs increased \$10.0 million to \$49.4 million for the nine months ended September 30, 2008 from \$39.4 million for the same period in 2007. This increase was attributable primarily to higher company-wide stock-based compensation, additional corporate facility personnel and operating costs to support our growth, post-implementation consulting costs and depreciation expense related to our new warehouse management system and increased corporate costs relating to the expansion of our network of retail stores. As a percentage of net revenues, corporate services costs decreased slightly to 9.0% for the nine months ended September 30, 2008 from 9.1% for the same period in 2007.

*Income from operations* decreased \$3.9 million, or 6.8%, to \$54.1 million for the nine months ended September 30, 2008 from \$58.0 million for the same period in 2007. Income from operations as a percentage of net revenues decreased to 9.9% for the nine months ended September 30, 2008 from 13.4% for the same period in 2007. This decrease was a result of an increase in selling, general and administrative expenses, primarily related to marketing costs, and a decrease in gross profit as a percentage of net revenues as discussed above.

*Other income (expense), net* decreased \$4.9 million to (\$2.0) million for the nine months ended September 30, 2008 from \$2.9 million for the same period in 2007. This decrease was primarily due to unrealized and realized foreign currency exchange rate losses, partially offset by unrealized and realized derivative financial instrument gains for the nine months ended September 30, 2008 as compared to unrealized and realized foreign



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currency exchange rate gains, partially offset by unrealized and realized derivative financial instrument losses for the same period in 2007. In addition, lower interest income was earned during the nine months ended September 30, 2008 as compared to the same period in 2007.

*Provision for income taxes* decreased \$3.1 million to \$22.1 million for the nine months ended September 30, 2008 from \$25.2 million for the same period in 2007. For the nine months ended September 30, 2008, our effective tax rate was 42.5% compared to 41.4% for the same period in 2007. Our annual 2008 effective tax rate is expected to be 42.7% compared to the 2007 annual effective tax rate of 41.0%. The increase in the 2008 full year effective tax rate is primarily attributable to an increase in the state income tax rate in Maryland, where our corporate headquarters is located.

*Net income* decreased \$5.8 million to \$29.9 million for the nine months ended September 30, 2008 from \$35.7 million for the same period in 2007, as a result of the factors described above.

## **Seasonality**

Historically, we have recognized a significant portion of our income from operations in the last two quarters of the year, driven by increased sales volume of our products during the fall selling season, reflecting our historical strength in fall sports, and the seasonality of our higher priced COLDGear® line. During 2008, a larger portion of our income from operations will be in the last two quarters of 2008 partially due to the shift in the timing of planned marketing investments to the first two quarters of 2008. The majority of our net revenues were generated during the last two quarters of 2007, 2006 and 2005. The level of our working capital generally reflects the seasonality and growth in our business. We generally expect inventory, accounts payable and certain accrued expenses to be higher in the second and third quarters in preparation for the fall selling season. Nonetheless, the historical high percentage of income from operations and net revenues in the second half of the year may have been in part due to our significant growth in net revenues.

## **Financial Position, Capital Resources and Liquidity**

Our cash requirements have principally been for working capital and capital expenditures. Working capital is primarily funded from cash flows provided by operating activities and cash and cash equivalents on hand. Our working capital requirements generally reflect the seasonality and growth in our business as we recognize a significant increase in sales leading up to the fall selling season. Since 2007, we have funded a portion of our working capital (primarily inventory) and capital investments from cash and cash equivalents on hand and borrowings available under our revolving credit and long term debt facilities. Our capital investments have included expanding our in-store fixture program, improvements and expansion of our distribution and corporate facilities to support our growth, leasehold improvements to our new retail stores, the investment and improvements in a company-wide Enterprise Resource Planning ( ERP ) system and the implementation of our new warehouse management system.

During 2007, our inventory strategy included increasing inventory levels to meet the anticipated consumer demand for our products. This included being in stock in core product offerings, which are products that we plan to have available for sale over the next twelve months and beyond at full price. In addition, our inventory strategy included shipping seasonal product at the start of the shipping window in order to maximize the productivity of our floor sets and earmarking any seasonal excess for our retail outlet stores. In 2008, we have continued to focus on meeting consumer demand while improving our inventory efficiency over the long term by putting systems and procedures in place to improve our production planning process. Based on these initiatives, we expect inventory to continue to increase, but at a rate below that of net revenues as we move through the remainder of 2008.

We believe that our cash and cash equivalents on hand, cash from operations and borrowings available to us under our revolving credit and long term debt facilities will be adequate to meet our liquidity needs and capital expenditure requirements for at least the next twelve months. We anticipate that our business will require

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additional capital to meet our longer term liquidity and future growth needs. Although we believe that we have adequate sources of liquidity, further weakening of economic conditions could adversely affect our business and liquidity (see the Risk Factors section included in our 2007 Form 10-K). In addition, continued instability in the credit and capital markets could adversely affect our ability to obtain capital and funding to grow our business and will affect the cost and terms of such capital and funding.

**Cash Flows**

The following table presents the major components of net cash flows used in and provided by operating, investing and financing activities for the periods presented:

| <i>(In thousands)</i>                                        | <b>Nine Months Ended<br/>September 30,</b> |             |
|--------------------------------------------------------------|--------------------------------------------|-------------|
|                                                              | <b>2008</b>                                | <b>2007</b> |
| Net cash (used in) provided by:                              |                                            |             |
| Operating activities                                         | \$ 6,553                                   | \$ (46,900) |
| Investing activities                                         | (33,709)                                   | (26,362)    |
| Financing activities                                         | 26,681                                     | 16,791      |
| Effect of exchange rate changes on cash and cash equivalents | 39                                         | 289         |
| Net decrease in cash and cash equivalents                    | \$ (436)                                   | \$ (56,182) |

*Operating Activities*

Operating activities consist primarily of net income adjusted for certain non-cash items. Non-cash items include depreciation and amortization, unrealized foreign currency exchange rate gains and losses, stock-based compensation, deferred income taxes and changes in reserves for doubtful accounts, returns, discounts and inventories. In addition, operating cash flows include the effect of changes in operating assets and liabilities, principally inventories, accounts receivable, income taxes payable and receivable, prepaid expenses and other assets, accounts payable and accrued expenses.

Cash provided by operating activities increased \$53.5 million to \$6.6 million for the nine months ended September 30, 2008 from cash used in operating activities of \$46.9 million during the same period in 2007. The increase in cash provided by operating activities was due to decreased cash outflows from operating assets and liabilities of \$45.7 million and increased non-cash items of \$13.6 million period over period, partially offset by a decrease in net income of \$5.8 million. The decrease in cash outflows related to changes in operating assets and liabilities period over period was primarily driven by the following:

a lower investment in inventory of \$72.3 million, primarily driven by the operational initiatives put in place to improve our inventory management; partially offset by

a lower increase in accounts payable of \$15.3 million primarily due to the lower increase in inventory levels and

a lower increase in accrued expenses and other liabilities of \$7.5 million in the nine months of 2008 as compared to the same period in 2007 primarily due to lower accruals for personnel costs in 2008.

Positive adjustments to net income for non-cash items increased in the nine months ended September 30, 2008 as compared to the same period of the prior year primarily as a result of higher depreciation and amortization expense relating to information technology initiatives, branded concept shops and the improvements to our distribution facilities; a lower increase in deferred income tax assets; and unrealized foreign currency exchange rate losses during 2008 as compared to unrealized foreign currency exchange rate gains during 2007.



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### *Investing Activities*

Cash used in investing activities, which includes capital expenditures and the purchase of trust owned life insurance policies, increased \$7.3 million to \$33.7 million for the nine months ended September 30, 2008 from \$26.4 million for the same period in 2007. This increase in cash used in investing activities is primarily due to the additional investments in our branded concept shops, in-store fixtures, retail stores and website, as well as the purchase of trust owned life insurance policies. This increase is partially offset by lower investments in our distribution facilities period over period.

Capital investments for the full year 2008 are anticipated to be approximately \$44.0 million, which include investments in our branded concept shops, and in-store fixtures and upgrades and improvements to our information technology infrastructure, including additional investments in our ERP system specific to inventory and financial planning and in our website. In addition, capital expenditures for the full year 2008 include improvements to our existing distribution facilities, the build out of new retail outlet and specialty stores and additional general corporate improvements to support our growth.

### *Financing Activities*

Cash provided by financing activities increased \$9.9 million to \$26.7 million for the nine months ended September 30, 2008 from \$16.8 million for the same period in 2007. This increase was primarily due to additional net proceeds received from our revolving credit and long term debt facilities, partially offset by lower excess tax benefits from stock-based compensation arrangements.

### *Revolving Credit Facility Agreement*

In December 2006, we entered into an amended and restated financing agreement with a lending institution. This financing agreement has a term of five years and provides for a committed revolving credit line of up to \$100.0 million based on our eligible domestic inventory and accounts receivable balances and may be used for working capital and general corporate purposes. This financing agreement is collateralized by substantially all of our domestic assets, other than our trademarks. Up to \$10.0 million of the facility may be used to support letters of credit, which if utilized would reduce the availability under the revolving credit facility.

The revolving credit facility bears interest based on the daily balance outstanding at our choice of LIBOR plus an applicable margin (varying from 1.0% to 2.0%) or the JP Morgan Chase Bank prime rate plus an applicable margin (varying from 0.0% to 0.5%). The applicable margin is calculated quarterly and varies based on our pricing leverage ratio as defined in the agreement. The revolving credit facility also carries a line of credit fee varying from 0.1% to 0.5% of the available but unused borrowings.

As of September 30, 2008, \$15.0 million was outstanding under the revolving credit facility and our net availability was \$85.0 million based on our eligible domestic inventory and accounts receivable balances. The weighted average interest rate on the balances outstanding under the revolving credit facilities was 3.5% and 6.8% for the three months ended September 30, 2008 and 2007, respectively, and 3.5% and 6.8% for the nine months ended September 30, 2008 and 2007, respectively. As of September 30, 2008 and October 31, 2008, the interest rates on the outstanding balances were 3.5% and 4.9%, respectively. In October 2008, we drew down an additional \$10.0 million under our revolving credit facility. We may consider additional borrowings to increase our cash position.

This financing agreement contains a number of restrictions that limit our ability, among other things, to pledge our accounts receivable, inventory, trademarks and most of our other assets as security in other borrowings or transactions; pay dividends on stock; redeem or acquire any of our securities; sell certain assets; make certain investments; guaranty certain obligations of third parties; undergo a merger or consolidation; or engage in any activity materially different from those presently conducted by us.

If net availability under the financing agreement falls below certain thresholds as defined in the agreement, we would be required to maintain a maximum leverage ratio of 1.25 and a minimum fixed charge coverage ratio

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of 1.10 to 1.25 as defined in the agreement. This financing agreement also provides the lenders with the ability to reduce the available revolving credit line amount even if we are in compliance with all conditions of the agreement, based on negative forecasts, trends or other circumstances that the lenders reasonably determine could negatively impact us or our business, profits, operations, financial condition or assets. Our net availability as of September 30, 2008 was well above the threshold for compliance with the financial covenants, and we were substantially below the maximum leverage ratio and substantially above the minimum fixed charge coverage ratio as of September 30, 2008.

*Long Term Debt*

In March 2005, we entered into an agreement to finance the acquisition or lease of up to \$17.0 million in qualifying capital investments. Loans under this agreement are collateralized by a first lien on the assets acquired. The agreement is not a committed facility, with each advance under the agreement subject to the lender's approval. In March 2008, the lender agreed to increase the maximum financing under the agreement to \$37.0 million.

In May 2008, we entered into an additional agreement to finance the acquisition or lease of up to \$40.0 million in qualifying capital investments. Loans under this additional agreement are collateralized by a first lien on the assets acquired. This additional agreement is not a committed facility, with each advance under the agreement subject to the lender's approval.

These agreements include a cross default provision whereby an event of default under other debt obligations, including the revolving credit facility agreement, will be considered an event of default under these agreements. At September 30, 2008 and December 31, 2007, the outstanding principal balance was \$22.0 million and \$13.4 million, respectively, under these agreements. Currently, advances under these agreements bear interest rates which are fixed at the time of each advance. The weighted average interest rate on outstanding borrowings was 5.9% and 6.6% for the three months ended September 30, 2008 and 2007, respectively, and 6.1% and 6.6% for the nine months ended September 30, 2008 and 2007, respectively.

The following is a schedule of future principal and interest payments on long term debt as of September 30, 2008:

*(In thousands)*

|                                            |           |
|--------------------------------------------|-----------|
| October 1 - December 31, 2008              | \$ 2,171  |
| 2009                                       | 8,041     |
| 2010                                       | 7,872     |
| 2011                                       | 3,742     |
| 2012 and thereafter                        | 2,326     |
| Total future payments on long term debt    | 24,152    |
| Less amount representing interest          | (2,155)   |
| Total principal payments on long term debt | 21,997    |
| Less current maturities of long term debt  | (7,192)   |
| Long term debt obligations                 | \$ 14,805 |

We monitor the financial health and stability of our lenders under the revolving credit and long term debt facilities, however current significant instability in the credit markets could negatively impact lenders and their ability to perform under their facilities.

**Table of Contents****Contractual Commitments and Contingencies**

Within the normal course of business, we enter into contractual commitments in order to promote our brand and products. These commitments include sponsorship agreements with teams and athletes on the collegiate and professional levels, official supplier agreements, athletic event sponsorships and other marketing commitments. The following is a schedule of our future minimum payments under our sponsorship and other marketing agreements as of September 30, 2008:

*(In thousands)*

|                               |          |
|-------------------------------|----------|
| October 1 - December 31, 2008 | \$ 3,699 |
| 2009                          | 22,408   |
| 2010                          | 19,873   |
| 2011                          | 16,212   |
| 2012 and thereafter           | 7,715    |

|                                                               |           |
|---------------------------------------------------------------|-----------|
| Total future minimum sponsorship and other marketing payments | \$ 69,907 |
|---------------------------------------------------------------|-----------|

The amounts listed above are the minimum obligations required to be paid under our sponsorship and other marketing agreements. The amounts listed above do not include additional incentives based on performance achievements while wearing or using our products and product supply obligations provided under some of these agreements. The other contractual commitments and contingencies included in our 2007 Form 10-K have not materially changed.

**Off-Balance Sheet Arrangements**

In connection with various contracts and agreements, we have agreed to indemnify counterparties against certain third party claims relating to the infringement of intellectual property rights and other items that fall under the scope of Financial Accounting Standards Board ( FASB ) Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. Based on our historical experience and the estimated probability of future loss, we have determined that the fair value of such indemnifications is not material to our financial position or results of operations.

**Critical Accounting Policies and Estimates**

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. To prepare these financial statements, we must make estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates also affect our reported revenues and expenses. Judgments must be made about the disclosure of contingent liabilities as well. Actual results could be significantly different from these estimates.

Our significant accounting policies are described in Note 2 of the audited consolidated financial statements included in our 2007 Form 10-K. The SEC's Financial Reporting Release ( FRR ) No. 60, *Cautionary Advice Regarding Disclosure About Critical Accounting Policies* ( FRR 60 ), suggests companies provide additional disclosure on those accounting policies considered most critical. FRR 60 considers an accounting policy to be critical if it is important to our financial condition and results of operations and requires significant judgment and estimates on the part of management in its application. Our estimates are often based on complex judgments, probabilities and assumptions that management believes to be reasonable, but that are inherently uncertain and unpredictable. It is also possible that other professionals, applying reasonable judgment to the same facts and circumstances, could develop and support a range of alternative estimated amounts. For a complete discussion of our critical accounting policies, see the Critical Accounting Policies section of the MD&A in our 2007 Form 10-K. There have been no significant changes to our critical accounting policies during the first nine months of 2008.

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### **Recently Adopted Accounting Standards**

In December 2007, the SEC issued Staff Accounting Bulletin ( SAB ) No. 110, *Share-Based Payment* ( SAB 110 ). SAB 110 amends SAB No. 107, *Share-Based Payment*, and allows for the continued use, under certain circumstances, of the simplified method in developing an estimate of the expected term on stock options accounted for under the Statement of Financial Accounting Standards ( SFAS ) No. 123R, *Share-Based Payment (revised 2004)*. SAB 110 is effective for stock options granted after December 31, 2007. We continued to use the simplified method in developing an estimate of the expected term on stock options granted in the first nine months of 2008. We do not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term due to the limited period of time our shares of Class A Common Stock have been publicly traded.

In February 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis. We adopted SFAS 159 in the first quarter of 2008 and did not choose to apply fair value accounting to any such assets or liabilities.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 was effective for fiscal years beginning after November 15, 2007, however the FASB has delayed the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities, except those items recognized or disclosed at fair value on an annual or more frequent basis. The adoption of SFAS 157 for financial assets and liabilities in the first quarter of 2008 did not have a material impact on our consolidated financial statements. We do not believe that the adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities will have a material impact on our consolidated financial statements. Refer to Note 7 of the consolidated financial statements for further information on fair value measurement.

### **Recently Issued Accounting Standards**

In June 2008, the FASB issued FASB Staff Position ( FSP ) Emerging Issues Task Force ( EITF ) No. 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* ( FSP EITF 03-6-1 ). FSP EITF 03-6-1 requires that unvested stock-based compensation awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) should be classified as participating securities and should be included in the computation of earnings per share pursuant to the two-class method as described by SFAS No. 128, *Earnings per Share*. The provisions of FSP EITF 03-6-1 are required for fiscal years beginning after December 15, 2008. We do not believe the adoption of FSP EITF 03-6-1 will have a material impact on our computation of earnings per share.

In June 2008, the FASB issued EITF Issue No. 07-5, *Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity's Own Stock* ( EITF 07-5 ). EITF 07-5 addresses the determination of whether provisions that introduce adjustment features (including contingent adjustment features) would prevent treating a derivative contract or an embedded derivative on a company's own stock as indexed solely to the company's stock. EITF 07-5 is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of adopting EITF 07-5 on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities* ( SFAS 161 ). SFAS 161 is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. The provisions of SFAS 161 are effective for the fiscal years and interim periods beginning after November 15, 2008. We do not believe the adoption of SFAS 161 will have a material impact on our consolidated financial statement disclosures.

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In December 2007, the FASB issued SFAS No. 141R, *Business Combinations (revised 2007)* ( SFAS 141R ). SFAS 141R replaces SFAS 141 and requires the acquirer of a business to recognize and measure the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree at fair value. SFAS 141R also requires transaction costs related to the business combination to be expensed as incurred. SFAS 141R is effective for business combinations for which the acquisition date is on or after fiscal years beginning after December 15, 2008. We do not believe the adoption of SFAS 141R will have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements-an amendment of ARB No. 51* ( SFAS 160 ). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for fiscal years beginning after December 15, 2008. We do not believe the adoption of SFAS 160 will have a material impact on our consolidated financial statements.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

#### *Foreign Currency Exchange and Foreign Currency Risk Management and Derivatives*

We currently generate a small amount of our consolidated net revenues in Canada and Europe. The reporting currency for our consolidated financial statements is the U.S. dollar. To date, net revenues generated outside of the United States have not been significant. However, as our net revenues generated outside of the United States increase, our results of operations could be adversely impacted by changes in foreign currency exchange rates. For example, if we recognize international sales in local foreign currencies (as we currently do in Canada and Europe) and if the U.S. dollar strengthens, it could have a negative impact on our international results upon translation of those results into the U.S. dollar upon consolidation of our financial statements. Adjustments that arise from foreign currency exchange rate changes on transactions denominated in a currency other than the local currency are included in other income (expense), net on the consolidated statements of income.

In August 2007, we began using foreign currency forward contracts to minimize some of the impact of foreign currency exchange rate fluctuations on future cash flows. We currently use foreign currency forward contracts to reduce the risk from exchange rate fluctuations on projected inventory purchases, inter-company transactions and other working capital requirements for our Canadian subsidiary. Management is currently evaluating similar hedging strategies for our European subsidiary. We do not enter into derivative financial instruments for speculative or trading purposes. Based on the foreign currency forward contracts outstanding as of September 30, 2008, we receive US Dollars in exchange for Canadian Dollars at a weighted average contractual foreign currency exchange rate of 1.03 CAD per \$1.00. As of September 30, 2008, the notional value of our outstanding forward contracts was approximately \$15.9 million with maturities of 1 to 9 months. The foreign currency forward contracts are not designated as cash flow hedges, and accordingly, changes in their fair value are recorded in other income (expense), net on the consolidated statements of income. As of September 30, 2008, the fair value of our foreign currency forward contracts was \$0.5 million which is included in prepaid expenses and other current assets on the consolidated balance sheet.



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Other income (expense), net included the following amounts related to changes in foreign currency exchange rates and derivative foreign currency forward contracts:

| <i>(In thousands)</i>                                    | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|----------------------------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                                          | 2008                                | 2007     | 2008                               | 2007     |
| Unrealized foreign currency exchange rate gains (losses) | \$ (1,697)                          | \$ 1,329 | \$ (1,517)                         | \$ 2,321 |
| Realized foreign currency exchange rate gains (losses)   | (490)                               | 71       | (882)                              | 350      |
| Unrealized derivative gains (losses)                     | 403                                 | (550)    | 750                                | (550)    |
| Realized derivative gains (losses)                       | 140                                 | (75)     | 116                                | (75)     |

Although we have entered into foreign currency forward contracts to minimize some of the impact of foreign currency exchange rate fluctuations on future cash flows, we cannot be assured that foreign currency exchange rate fluctuations will not have a material adverse impact on our financial condition and results of operations.

**ITEM 4. CONTROLS AND PROCEDURES**

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

In April 2008, we implemented a new warehouse management system to replace our legacy warehouse management system. This change materially affected or was reasonably likely to materially affect our internal control over financial reporting during the second fiscal quarter. During the most recent fiscal quarter, we continued to make appropriate changes to internal controls and procedures as the implementation progressed, but none were material to the internal control over financial reporting. Therefore, there has been no change in our internal control over financial reporting during the most recent fiscal quarter that has materially affected, or that is reasonably likely to materially affect our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

The Risk Factors included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2007 have not materially changed.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

From July 28, 2008 through September 12, 2008, we issued 19.5 thousand shares of Class A Common Stock upon the exercise of previously granted stock options to employees at a weighted average exercise price of \$3.90 per share, for an aggregate amount of consideration of approximately \$76.1 thousand.

The issuances of securities described above were made in reliance upon Section 4(2) under the Securities Act in that any issuance did not involve a public offering or under Rule 701 promulgated under the Securities Act, in that they were offered and sold either pursuant to written compensatory plans or pursuant to a written contract relating to compensation, as provided by Rule 701.

**ITEM 6. EXHIBITS**

| <b>Exhibit No.</b> |                                                   |
|--------------------|---------------------------------------------------|
| 31.01              | Section 302 Chief Executive Officer Certification |
| 31.02              | Section 302 Chief Financial Officer Certification |
| 32.01              | Section 906 Chief Executive Officer Certification |
| 32.02              | Section 906 Chief Financial Officer Certification |

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNDER ARMOUR, INC.

By: /s/ BRAD DICKERSON  
Brad Dickerson

*Chief Financial Officer*

Dated: November 5, 2008