

FOSSIL INC
Form 10-Q
August 11, 2011

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: July 2, 2011

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 number: 000-19848

FOSSIL, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

75-2018505
(I.R.S. Employer
Identification No.)

2280 N. Greenville Avenue, Richardson, Texas 75082

(Address of principal executive offices)

(Zip Code)

(972) 234-2525

(Registrant's telephone number, including area code)

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

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

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

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

The number of shares of the registrant's common stock outstanding as of August 5, 2011: 63,098,630.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FOSSIL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

UNAUDITED

IN THOUSANDS

| | July 2, 2011 | January 1, 2011 |
|--|---------------------|---------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 323,454 | \$ 392,794 |
| Securities available for sale | 8,729 | 8,864 |
| Accounts receivable - net of allowances of \$76,800 and \$80,659, respectively | 226,060 | 263,218 |
| Inventories | 450,698 | 371,935 |
| Deferred income tax assets - net | 42,819 | 41,836 |
| Prepaid expenses and other current assets | 99,080 | 62,170 |
| Total current assets | 1,150,840 | 1,140,817 |
| Investments | 7,620 | 9,023 |
| Property, plant and equipment - net of accumulated depreciation of \$215,445 and \$205,312, respectively | 226,697 | 217,424 |
| Goodwill | 45,960 | 44,572 |
| Intangible and other assets - net | 62,456 | 55,737 |
| Total long-term assets | 342,733 | 326,756 |
| Total assets | \$ 1,493,573 | \$ 1,467,573 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 146,854 | \$ 122,266 |
| Short-term debt | 8,870 | 5,314 |
| Accrued expenses: | | |
| Compensation | 44,400 | 51,374 |
| Royalties | 28,140 | 39,731 |
| Co-op advertising | 12,532 | 23,101 |
| Transaction taxes | 13,380 | 18,894 |
| Other | 69,132 | 50,779 |
| Income taxes payable | 22,121 | 28,029 |
| Total current liabilities | 345,429 | 339,488 |
| Long-term income taxes payable | 14,479 | 9,088 |
| Deferred income tax liabilities | 58,911 | 47,893 |
| Long-term debt | 4,814 | 4,513 |
| Other long-term liabilities | 24,817 | 14,883 |
| Total long-term liabilities | 103,021 | 76,377 |

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Commitments and contingencies (Note 9)

Stockholders' equity:

| | | |
|--|------------------|------------------|
| Common stock, 68,328 and 67,882 shares issued as of July 2, 2011 and January 1, 2011, respectively | 683 | 679 |
| Treasury stock, at cost, 5,071 and 3,206 shares as of July 2, 2011 and January 1, 2011, respectively | (338,364) | (183,014) |
| Additional paid-in capital | 134,862 | 117,215 |
| Retained earnings | 1,197,003 | 1,089,820 |
| Accumulated other comprehensive income | 42,207 | 19,418 |
| Noncontrolling interest | 8,732 | 7,590 |
| Total stockholders' equity | 1,045,123 | 1,051,708 |
| | | |
| Total liabilities and stockholders' equity | \$ 1,493,573 | \$ 1,467,573 |

See notes to the condensed consolidated financial statements.

FOSSIL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

AND COMPREHENSIVE INCOME

UNAUDITED

IN THOUSANDS, EXCEPT PER SHARE DATA

| | For the 13 Weeks Ended | | For the 26 Weeks Ended | |
|--|------------------------|--------------|------------------------|--------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| Net sales | \$ 556,661 | \$ 412,560 | \$ 1,093,635 | \$ 805,789 |
| Cost of sales | 244,685 | 175,675 | 479,847 | 349,485 |
| Gross profit | 311,976 | 236,885 | 613,788 | 456,304 |
| Operating expenses: | | | | |
| Selling and distribution | 164,606 | 129,192 | 322,990 | 254,047 |
| General and administrative | 61,108 | 43,347 | 111,980 | 86,648 |
| Total operating expenses | 225,714 | 172,539 | 434,970 | 340,695 |
| Operating income | 86,262 | 64,346 | 178,818 | 115,609 |
| Interest expense | 649 | 59 | 874 | 117 |
| Other (expense) income - net | (3,925) | 237 | (6,998) | 2,771 |
| Income before income taxes | 81,688 | 64,524 | 170,946 | 118,263 |
| Provision for income taxes | 27,657 | 7,965 | 58,850 | 24,008 |
| Net income | 54,031 | 56,559 | 112,096 | 94,255 |
| Less: Net income attributable to noncontrolling interest | 2,670 | 2,074 | 4,914 | 3,863 |
| Net income attributable to Fossil, Inc. | \$ 51,361 | \$ 54,485 | \$ 107,182 | \$ 90,392 |
| Other comprehensive income (loss), net of taxes: | | | | |
| Currency translation adjustment | 10,581 | (17,211) | 29,907 | (35,191) |
| Unrealized gain (loss) on securities available for sale | 188 | 114 | (248) | 298 |
| Forward contracts hedging intercompany foreign currency payments - change in fair values | (2,023) | 3,861 | (6,870) | 9,457 |
| Total comprehensive income | 62,777 | 43,323 | 134,885 | 68,819 |
| Less: Comprehensive income attributable to noncontrolling interest | 2,670 | 2,062 | 4,914 | 3,842 |
| Comprehensive income attributable to Fossil, Inc. | \$ 60,107 | \$ 41,261 | \$ 129,971 | \$ 64,977 |
| Earnings per share: | | | | |
| Basic | \$ 0.81 | \$ 0.81 | \$ 1.68 | \$ 1.34 |
| Diluted | \$ 0.80 | \$ 0.80 | \$ 1.66 | \$ 1.33 |

Weighted average common shares outstanding:

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| | | | | |
|---------|--------|--------|--------|--------|
| Basic | 63,411 | 67,446 | 63,743 | 67,235 |
| Diluted | 64,124 | 68,278 | 64,477 | 68,111 |

See notes to the condensed consolidated financial statements.

FOSSIL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

UNAUDITED

IN THOUSANDS

| | For the 26 Weeks Ended | |
|---|------------------------|--------------|
| | July 2, 2011 | July 3, 2010 |
| Operating Activities: | | |
| Net income | \$ 112,096 | \$ 94,255 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, amortization and accretion | 25,060 | 20,036 |
| Stock-based compensation | 5,910 | 4,500 |
| (Decrease) increase in allowance for returns - net of inventory in transit | (2,316) | 2,138 |
| Loss on disposal of assets | 924 | 101 |
| Impairment losses | 0 | 2,476 |
| Equity in loss (income) of joint venture | 73 | (687) |
| Distribution from joint venture | 2,226 | 4,726 |
| Decrease in allowance for doubtful accounts | (755) | (1,273) |
| Excess tax benefits from stock-based compensation | (9,333) | (2,975) |
| Deferred income taxes and other | 10,672 | 11,754 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 49,772 | 44,191 |
| Inventories | (66,953) | (49,946) |
| Prepaid expenses and other current assets | (35,027) | (17,670) |
| Accounts payable | 8,644 | (15,523) |
| Accrued expenses | (25,938) | 1,108 |
| Income taxes payable | 8,112 | (26,563) |
| Net cash provided by operating activities | 83,167 | 70,648 |
| Investing Activities: | | |
| Additions to property, plant and equipment | (30,429) | (17,626) |
| Increase in intangible and other assets | (6,465) | (2,371) |
| Purchase of securities available for sale | (222) | (302) |
| Sales/maturities of securities available for sale | 111 | 151 |
| Proceeds from the sale of property, plant and equipment | 21,251 | 0 |
| Net cash used in investing activities | (15,754) | (20,148) |
| Financing Activities: | | |
| Acquisition of common stock | (155,350) | (11,157) |
| Distribution of noncontrolling interest earnings | (3,772) | (4,272) |
| Excess tax benefits from stock-based compensation | 9,333 | 2,975 |
| Borrowings on notes payable | 10,276 | 46 |
| Payments on notes payable | (6,870) | (221) |
| Proceeds from exercise of stock options | 7,728 | 9,544 |
| Net cash used in financing activities | (138,655) | (3,085) |
| Effect of exchange rate changes on cash and cash equivalents | 1,902 | (18,046) |
| Net (decrease) increase in cash and cash equivalents | (69,340) | 29,369 |
| Cash and cash equivalents: | | |
| Beginning of period | 392,794 | 405,175 |

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| | | |
|---------------|------------|------------|
| End of period | \$ 323,454 | \$ 434,544 |
|---------------|------------|------------|

See notes to the condensed consolidated financial statements.

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

UNAUDITED

1. FINANCIAL STATEMENT POLICIES

Basis of Presentation. The condensed consolidated financial statements include the accounts of Fossil, Inc., a Delaware corporation, and its wholly and majority-owned subsidiaries (the Company). The condensed consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary to present a fair statement of the Company's financial position as of July 2, 2011, and the results of operations for the thirteen week periods ended July 2, 2011 (Second Quarter) and July 3, 2010 (Prior Year Quarter), respectively, and the twenty-six week periods ended July 2, 2011 (Year To Date Period) and July 3, 2010 (Prior Year YTD Period), respectively. All adjustments are of a normal, recurring nature.

These interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Annual Report on Form 10-K filed by the Company pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act), for the fiscal year ended January 1, 2011. Operating results for the thirteen and twenty-six week periods ended July 2, 2011 are not necessarily indicative of the results to be achieved for the full year.

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the condensed consolidated financial statements and revenues and expenses during the periods reported. Actual results could differ from those estimates. The Company has not made any changes in its significant accounting policies from those disclosed in its most recent annual report.

Business. The Company is a global design, marketing and distribution company that specializes in consumer fashion accessories. Its principal offerings include an extensive line of men's and women's fashion watches and jewelry, handbags, small leather goods, belts, sunglasses, soft accessories, shoes and clothing. In the watch and jewelry product category, the Company has a diverse portfolio of globally recognized owned and licensed brand names under which its products are marketed. The Company's products are distributed globally through various distribution channels including wholesale in countries where it has a physical presence, direct to the consumer through its retail stores and commercial websites and through third-party distributors in countries where the Company does not maintain a physical presence. The Company's products are offered at varying price points to service the needs of its customers, whether they are value conscious or luxury oriented. Based on its extensive range of accessory products, brands, distribution channels and price points, the Company is able to target style-conscious consumers across a wide age spectrum on a global basis.

Foreign Currency Hedging Instruments. The Company's foreign subsidiaries periodically enter into forward contracts principally to hedge the future payment of intercompany inventory transactions in U.S. dollars. If the Company's foreign subsidiaries were to settle their contracts designated as cash flow hedges that were denominated in European Euros, British Pounds, Mexican Pesos, Australian Dollars, Canadian Dollars and Japanese Yen, the net result would be a loss of approximately \$13.7 million, net of taxes, as of July 2, 2011. Refer to Note 6 Derivatives and Risk Management in the condensed consolidated financial statements for additional disclosures about the Company's use of forward contracts. The tax benefit of changes in fair value of hedging activities for the Second Quarter and Year To Date Period were \$0.6 million and \$0.2 million, respectively. The tax expense of changes in fair value of hedging activities for the Prior Year Quarter and Prior Year YTD Period was \$0.8 million and \$0.7 million, respectively.

Fair Value Measurements. The Company defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date.

Accounting Standard Codification (ASC) 820, *Fair Value Measurement and Disclosures* (ASC 820), establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1 - Quoted prices in active markets for identical assets or liabilities.

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Level 2 - Inputs, other than quoted prices in active markets, that are observable either directly or indirectly.

Level 3 - Unobservable inputs based on the Company's assumptions.

ASC 820 requires the use of observable market data if such data is available without undue cost and effort.

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

The following tables present the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis (in thousands):

| | Fair Value at July 2, 2011 | | | Total |
|---|----------------------------|--------------|-------------|------------------|
| | Level 1 | Level 2 | Level 3 | |
| Assets: | | | | |
| Securities available for sale: | | | | |
| Investments in bonds | \$ 7,974 | \$ 0 | \$ 0 | \$ 7,974 |
| Investment in publicly traded equity securities | 756 | 0 | 0 | 756 |
| Foreign exchange forward contracts | 0 | 85 | 0 | 85 |
| Deferred compensation plan assets: | | | | |
| Investment in publicly traded mutual funds | 3,414 | 0 | 0 | 3,414 |
| Total | \$ 12,144 | \$ 85 | \$ 0 | \$ 12,229 |

| | | | | |
|------------------------------------|-------------|------------------|-------------|------------------|
| Liabilities: | | | | |
| Foreign exchange forward contracts | \$ 0 | \$ 16,475 | \$ 0 | \$ 16,475 |
| Total | \$ 0 | \$ 16,475 | \$ 0 | \$ 16,475 |

| | Fair Value at January 1, 2011 | | | Total |
|---|-------------------------------|-----------------|-------------|------------------|
| | Level 1 | Level 2 | Level 3 | |
| Assets: | | | | |
| Securities available for sale: | | | | |
| Investments in bonds | \$ 7,705 | \$ 0 | \$ 0 | \$ 7,705 |
| Investment in publicly traded equity securities | 1,159 | 0 | 0 | 1,159 |
| Foreign exchange forward contracts | 0 | 1,628 | 0 | 1,628 |
| Deferred compensation plan assets: | | | | |
| Investment in publicly traded mutual funds | 3,295 | 0 | 0 | 3,295 |
| Total | \$ 12,159 | \$ 1,628 | \$ 0 | \$ 13,787 |

| | | | | |
|------------------------------------|-------------|------------------|-------------|------------------|
| Liabilities: | | | | |
| Foreign exchange forward contracts | \$ 0 | \$ 10,222 | \$ 0 | \$ 10,222 |
| Total | \$ 0 | \$ 10,222 | \$ 0 | \$ 10,222 |

The fair values of the Company's securities available for sale and deferred compensation plan assets are based on quoted prices. The deferred compensation plan assets are recorded within intangible and other assets net. The foreign exchange forward contracts are entered into by the Company principally to hedge the future payment of intercompany inventory transactions by non-U.S. subsidiaries. The fair values of the Company's foreign exchange forward contracts are based on published quotations of spot currency rates and forward points, which are converted into implied forward currency rates.

The Company has evaluated its short-term and long-term debt and believes, based on the interest rates, related terms and maturities, that the fair values of such instruments approximate their carrying amounts. As of July 2, 2011 and January 1, 2011, the carrying values of cash and cash

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equivalents, accounts receivable, accounts payable and accrued liabilities approximated their fair values due to the short-term maturities of these accounts.

Earnings Per Share (EPS). Basic EPS is based on the weighted average number of common shares outstanding during each period. Diluted EPS adjusts basic EPS for the effects of dilutive common stock equivalents outstanding during each period using the treasury stock method.

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

The following table reconciles the numerators and denominators used in the computations of both basic and diluted EPS (in thousands, except per share data):

| | For the 13 Weeks Ended | | For the 26 Weeks Ended | |
|---|------------------------|--------------|------------------------|--------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| Numerator: | | | | |
| Net income attributable to Fossil, Inc. | \$ 51,361 | \$ 54,485 | \$ 107,182 | \$ 90,392 |
| Denominator: | | | | |
| Basic EPS computation: | | | | |
| Basic weighted average common shares outstanding | 63,411 | 67,446 | 63,743 | 67,235 |
| Basic EPS | \$ 0.81 | \$ 0.81 | \$ 1.68 | \$ 1.34 |
| Diluted EPS computation: | | | | |
| Basic weighted average common shares outstanding | 63,411 | 67,446 | 63,743 | 67,235 |
| Stock options, stock appreciation rights and restricted stock units | 713 | 832 | 734 | 876 |
| Diluted weighted average common shares outstanding | 64,124 | 68,278 | 64,477 | 68,111 |
| Diluted EPS | \$ 0.80 | \$ 0.80 | \$ 1.66 | \$ 1.33 |

Approximately 49,000, 2,000 and 205,000 weighted average shares issuable under stock-based awards were not included in the diluted EPS calculation at the end of the Prior Year Quarter, Year To Date Period and Prior Year YTD Period, respectively, because they were antidilutive. These common share equivalents may be dilutive in future EPS calculations. All outstanding shares issuable under stock-based awards were dilutive during the Second Quarter.

Goodwill. The changes in the carrying amount of goodwill, which is not subject to amortization, are as follows (in thousands):

| | North America Wholesale | Europe Wholesale | Asia Pacific Wholesale | Direct to Consumer | Total |
|----------------------------|-------------------------------|---------------------|------------------------------|-----------------------|-----------|
| Balance at January 1, 2011 | \$ 23,838 | \$ 18,120 | \$ 2,614 | \$ 0 | \$ 44,572 |
| Foreign currency changes | 129 | 1,236 | 23 | 0 | 1,388 |
| Balance at July 2, 2011 | \$ 23,967 | \$ 19,356 | \$ 2,637 | \$ 0 | \$ 45,960 |

2. INVENTORIES

Inventories consist of the following (in thousands):

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| | July 2, 2011 | January 1, 2011 |
|--------------------------------|-------------------|-------------------|
| Components and parts | \$ 42,508 | \$ 23,292 |
| Work-in-process | 5,748 | 4,176 |
| Inventory purchases in transit | 62,837 | 47,455 |
| Finished goods | 339,605 | 297,012 |
| Inventories | \$ 450,698 | \$ 371,935 |

3. INCOME TAXES

The Company's income tax expense and related effective rate were as follows (in thousands, except percentage data):

| | For the 13 Weeks Ended July 2, 2011 | For the 13 Weeks Ended July 3, 2010 | For the 26 Weeks Ended July 2, 2011 | For the 26 Weeks Ended July 3, 2010 |
|--------------------|--|--|--|--|
| Income tax expense | \$ 27,657 | \$ 7,965 | \$ 58,850 | \$ 24,008 |
| Income tax rate | 33.9% | 12.3% | 34.4% | 20.3% |

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

The lower effective tax rates in the Prior Year Quarter and Prior Year YTD Period were attributable to the recognition of previously unrecognized tax benefits during the Prior Year Quarter.

As of July 2, 2011, the total amount of unrecognized tax benefits, excluding interest and penalties, was \$15.6 million, of which \$12.5 million would favorably impact the effective tax rate in future periods, if recognized. During the Prior Year Quarter, the examination phase of the Internal Revenue Service (IRS) audit for tax years 2005 and 2006 was completed. The IRS proposed certain adjustments and the Company filed a protest. This protest is under review by the IRS Office of Appeals and it is possible that it may be resolved within the next twelve months. The Company is also subject to examinations in various state and foreign jurisdictions for the 2004-2009 tax years, none of which are individually significant. Audit outcomes and the timing of audit settlements are subject to significant uncertainty.

The Company has classified uncertain tax positions as long-term income taxes payable unless such amounts are expected to be paid within twelve months of the condensed consolidated balance sheet date. As of July 2, 2011, the Company has recorded unrecognized tax benefits of \$2.7 million, excluding interest and penalties, for positions that could be settled within the next twelve months. Consistent with its past practice, the Company recognizes interest and/or penalties related to income tax overpayments and income tax underpayments in income tax expense and income taxes payable, respectively. The total amount of accrued income tax-related interest included in the condensed consolidated balance sheet at July 2, 2011 was \$2.0 million. There were no penalties accrued in the condensed consolidated balance sheet at July 2, 2011. For the Second Quarter, the Company accrued income tax-related interest expense of \$0.2 million.

4. STOCKHOLDERS EQUITY AND BENEFIT PLANS

Common Stock Repurchase Programs. Purchases of the Company's common stock are made from time to time, subject to market conditions and at prevailing market prices, through the open market. Repurchased shares of common stock are recorded at cost and become authorized but unissued shares which may be issued in the future for general corporate and other purposes. The Company may terminate or limit the stock repurchase program at any time. In the event the repurchased shares are cancelled, the Company accounts for retirements by allocating the repurchase price to common stock, additional paid-in capital and retained earnings. The repurchase price allocation is based upon the equity contribution associated with historical issuances. The Company's repurchase programs are conducted pursuant to Rule 10b-18 of the Exchange Act.

The following table reflects the Company's common stock repurchase activity for the periods indicated (in millions).

| Period authorized | Dollar value authorized | Termination date | For the 13 Weeks Ended July 2, 2011 | | For the 26 Weeks Ended July 2, 2011 | | For the 2010 Fiscal Year | |
|-------------------|-------------------------|------------------|-------------------------------------|--------------------------|-------------------------------------|--------------------------|------------------------------|--------------------------|
| | | | Number of shares repurchased | Dollar value repurchased | Number of shares repurchased | Dollar value repurchased | Number of shares repurchased | Dollar value repurchased |
| Fiscal Year 2010 | \$ 30.0 | None | 0.0 | \$ 0.0 | 0.0 | \$ 0.0 | 0.0 | \$ 0.0 |
| Fiscal Year 2010 | \$ 750.0 | December 2013 | 0.6 | \$ 60.9 | 1.9 | \$ 155.4 | 3.1 | \$ 179.2 |
| Fiscal Year 2009 | \$ 20.0 | None | | | | | 0.5 | \$ 20.0 |

Stock-Based Compensation Plans. The Company accounts for stock-based compensation in accordance with the provisions of ASC 718, *Compensation - Stock Compensation* (ASC 718), using the Black-Scholes option pricing model to determine the fair value of stock options and stock appreciation rights at the date of grant. The Company's current stock-based compensation plans include: (a) stock options and restricted stock for its international employees, (b) stock options and restricted stock units for its non-employee directors and (c) stock appreciation rights, restricted stock and restricted stock units for its U.S.-based employees.

There have been no significant changes to the Company's stock-based compensation plans since the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2011.

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

The following table summarizes stock options and stock appreciation rights activity during the Second Quarter:

| Stock Options and Stock Appreciation Rights | Shares IN THOUSANDS | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value IN THOUSANDS |
|---|------------------------|---------------------------------------|---|--|
| Outstanding at April 2, 2011 | 1,468 | \$ 35.41 | 6.4 | \$ 85,452 |
| Granted | 6 | 93.29 | | |
| Exercised | (230) | 26.24 | | 18,490 |
| Forfeited or expired | (1) | 8.84 | | |
| Outstanding at July 2, 2011 | 1,243 | 37.39 | 6.4 | 105,130 |
| Exercisable at July 2, 2011 | 498 | 24.17 | 4.5 | 48,735 |
| Nonvested at July 2, 2011 | 745 | 46.24 | 7.6 | 56,396 |
| Expected to vest | 690 | \$ 46.24 | 7.6 | \$ 52,321 |

The aggregate intrinsic value in the table above is before income taxes and is based on the exercise price for outstanding and exercisable stock options and stock appreciation rights at July 2, 2011 and the fair market value on the exercise date for stock options and stock appreciation rights that have been exercised during the Second Quarter.

Stock Options and Stock Appreciation Rights Outstanding and Exercisable. The following table summarizes information with respect to stock options and stock appreciation rights outstanding and exercisable at July 2, 2011:

| Range of Exercise Prices | Stock Options and Stock Appreciation Rights Outstanding | | | Stock Options and Stock Appreciation Rights Exercisable | |
|--------------------------|---|---|--|---|--|
| | Number of Shares IN THOUSANDS | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term (Years) | Number of Shares IN THOUSANDS | Weighted- Average Exercise Price |
| \$0 - \$9.33 | 12 | \$ 9.22 | 0.5 | 12 | \$ 9.22 |
| \$9.33 - \$18.66 | 309 | 14.32 | 5.5 | 158 | 14.77 |
| \$18.66 - \$27.99 | 201 | 23.59 | 3.5 | 171 | 23.82 |
| \$27.99 - \$37.31 | 223 | 31.09 | 5.7 | 89 | 30.98 |
| \$37.31 - \$65.30 | 241 | 39.02 | 7.7 | 68 | 40.61 |
| \$65.30 - \$74.63 | 6 | 69.53 | 9.5 | 0 | 0.00 |
| \$74.63 - \$83.96 | 245 | 81.23 | 9.2 | 0 | 0.00 |
| \$83.96 - \$93.29 | 6 | 93.29 | 9.8 | 0 | 0.00 |
| Total | 1,243 | \$ 37.39 | 6.4 | 498 | \$ 24.17 |

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

UNAUDITED

Restricted Stock and Restricted Stock Units. The following table summarizes restricted stock and restricted stock unit activity during the Second Quarter:

| Restricted Stock and Restricted Stock Units | Number of Shares | Weighted-Average Grant-Date Fair Value |
|---|------------------|--|
| | IN THOUSANDS | |
| Nonvested at April 2, 2011 | 383 | \$ 40.94 |
| Granted | 10 | 99.69 |
| Vested | (30) | 36.18 |
| Forfeited | (3) | 35.27 |
| Nonvested at July 2, 2011 | 360 | 43.00 |
| Expected to vest | 324 | \$ 43.00 |

The total fair value of restricted stock and restricted stock units vested during the Second Quarter was approximately \$3.0 million.

5. SEGMENT INFORMATION

The Company manages its business primarily on a geographic basis. The Company's reportable operating segments are comprised of North America Wholesale, Europe Wholesale, Asia Pacific Wholesale and Direct to Consumer. The North America Wholesale, Europe Wholesale and Asia Pacific Wholesale reportable segments do not include activities related to the Direct to Consumer segment. The North America Wholesale segment primarily includes sales to wholesale or distributor customers based in Canada, Mexico, the United States and countries in South America. The Europe Wholesale segment primarily includes sales to wholesale or distributor customers based in European countries, the Middle East and Africa. The Asia Pacific Wholesale segment primarily includes sales to wholesale or distributor customers based in Australia, China (including the Company's assembly and procurement operations), India, Indonesia, Japan, Malaysia, New Zealand, Singapore, South Korea, Taiwan and Thailand. The Direct to Consumer segment includes Company-owned retail stores, e-commerce sales and catalog activities. Each reportable operating segment provides similar products and services.

The Company evaluates the performance of its reportable segments based on net sales and operating income. Net sales for geographic segments are generally based on the location of the customers. Operating income for each segment includes net sales to third-parties, related cost of sales and operating expenses directly attributable to the segment. General corporate expenses, including certain administrative, legal, accounting, technology support costs, equity compensation costs, payroll costs attributable to executive management and amounts related to intercompany eliminations are not allocated to the various segments. Intercompany sales of products between segments are referred to as intersegment items.

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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Summary information by operating segment is as follows (in thousands):

| | For the 13 Weeks Ended July 2, 2011 | | For the 13 Weeks Ended July 3, 2010 | |
|--------------------------|--|----------------------------|--|----------------------------|
| | Net Sales | Operating Income (Loss) | Net Sales | Operating Income (Loss) |
| North America Wholesale: | | | | |
| External customers | \$ 213,064 | \$ 56,172 | \$ 155,868 | \$ 40,687 |
| Intersegment | 33,372 | | 15,592 | |
| Europe Wholesale: | | | | |
| External customers | 141,790 | 29,403 | 107,698 | 28,803 |
| Intersegment | 29,597 | | 13,663 | |
| Asia Pacific Wholesale: | | | | |
| External customers | 67,856 | 23,301 | 46,446 | 9,607 |
| Intersegment | 148,374 | | 140,453 | |
| Direct to Consumer | 133,951 | 14,756 | 102,548 | 11,320 |
| Intersegment items | (211,343) | | (169,708) | |
| Corporate | | (37,370) | | (26,071) |
| Consolidated | \$ 556,661 | \$ 86,262 | \$ 412,560 | \$ 64,346 |

| | For the 26 Weeks Ended July 2, 2011 | | For the 26 Weeks Ended July 3, 2010 | |
|--------------------------|--|----------------------------|--|----------------------------|
| | Net Sales | Operating Income (Loss) | Net Sales | Operating Income (Loss) |
| North America Wholesale: | | | | |
| External customers | \$ 419,800 | \$ 106,504 | \$ 309,664 | \$ 70,534 |
| Intersegment | 63,791 | | 52,285 | |
| Europe Wholesale: | | | | |
| External customers | 293,620 | 67,515 | 220,168 | 52,218 |
| Intersegment | 64,730 | | 26,909 | |
| Asia Pacific Wholesale: | | | | |
| External customers | 132,071 | 45,549 | 85,150 | 26,443 |
| Intersegment | 284,057 | | 235,348 | |
| Direct to Consumer | 248,144 | 22,907 | 190,807 | 16,208 |
| Intersegment items | (412,578) | | (314,542) | |
| Corporate | | (63,657) | | (49,794) |
| Consolidated | \$ 1,093,635 | \$ 178,818 | \$ 805,789 | \$ 115,609 |

The following table shows revenue for each class of similar products in the periods presented (in thousands):

| | For the 13 Weeks Ended | | For the 26 Weeks Ended | |
|--|------------------------|--------------|------------------------|--------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |

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| | | | | |
|----------|------------|------------|--------------|------------|
| Watches | \$ 399,627 | \$ 287,821 | \$ 772,336 | \$ 542,713 |
| Leathers | 91,690 | 68,009 | 182,239 | 142,772 |
| Jewelry | 38,483 | 32,191 | 80,649 | 66,194 |
| Other | 26,861 | 24,539 | 58,411 | 54,110 |
| Total | \$ 556,661 | \$ 412,560 | \$ 1,093,635 | \$ 805,789 |

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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6. DERIVATIVES AND RISK MANAGEMENT

The Company is exposed to certain risks relating to its ongoing business operations, which it attempts to manage by using derivative instruments. The primary risks managed by using derivative instruments are the fluctuations in global currencies that will ultimately be used to settle future payments of intercompany inventory transactions denominated in U.S. dollars by non-U.S. dollar functional currency subsidiaries. Specifically, the Company projects future intercompany purchases by its non-U.S. dollar functional currency subsidiaries generally over a period of up to 18 months. The Company enters into foreign currency forward contracts (forward contracts) generally for up to 65% of the forecasted purchases to manage fluctuations in global currencies that will ultimately be used to settle such U.S. dollar denominated inventory purchases. Forward contracts represent agreements to exchange the currency of one country for the currency of another country at an agreed-upon settlement date. The majority of the Company s forward contracts are designated as single cash flow hedges. Fluctuations in exchange rates will either increase or decrease the Company s U.S. dollar equivalent cash flows from these intercompany inventory transactions, which will affect the Company s U.S. dollar earnings. Gains or losses on the forward contracts are expected to offset these fluctuations to the extent the cash flows are hedged by the forward contracts. The Company also periodically enters into forward contracts to manage exchange rate risks associated with certain non-inventory intercompany transactions and to which the Company does not elect hedge treatment. The Company did not have any outstanding forward contracts not designated as hedging instruments at July 2, 2011 or January 1, 2011.

The Company s forward contracts purchased to hedge exchange rate risk associated with intercompany inventory transactions meet the criteria for hedge eligibility, which requires that they represent foreign-currency-denominated forecasted intra-entity transactions in which (1) the operating unit that has the foreign currency exposure is a party to the hedging instrument and (2) the hedged transaction is denominated in a currency other than the hedging unit s functional currency. At the inception of the hedge, the hedging relationship is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk. The Company assesses hedge effectiveness under the critical terms matched method at inception and at least quarterly throughout the life of the hedging relationship. If the critical terms (i.e. amounts, currencies and settlement dates) of the forward currency exchange contract match the terms of the forecasted transaction, the Company concludes that there is no hedge ineffectiveness. The Company s cash flow hedges resulted in no ineffectiveness in the condensed consolidated statements of income and comprehensive income for all reporting periods.

The accounting for gains and losses that result from changes in the fair values of derivative instruments depends on whether the derivatives have been designated and qualify as hedging instruments. Changes in the fair value of derivatives not designated as hedging instruments are recognized in earnings when they occur. For a derivative instrument that is designated and qualifies as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (loss), net of taxes and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. Due to the high degree of effectiveness between the hedging instruments and the underlying exposures being hedged, the Company s hedges resulted in no ineffectiveness in the condensed consolidated statements of income and comprehensive income, and there were no components excluded from the assessment of hedge effectiveness for the Second Quarter, Prior Year Quarter, Year To Date Period and the Prior Year YTD Period.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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All derivative instruments are recognized as either assets or liabilities at fair value in the statement of financial position. Forward contracts designated as cash flow hedges are recorded at fair value at each balance sheet date and the change in fair value is recorded to accumulated other comprehensive income (loss) within the equity section of the balance sheet until such forward contract gains (losses) become realized or the cash flow hedge relationship is terminated. If the cash flow hedge relationship is terminated, the derivatives gains or losses that are deferred in accumulated other comprehensive income (loss) will be recognized in earnings when the hedged cash flows occur. However, for cash flow hedges that are terminated because the forecasted transaction is not expected to occur in the original specified time period, the derivative gains or losses are immediately recognized in earnings. There were no gains or losses reclassified into earnings as a result of the discontinuance of cash flow hedges as of July 2, 2011 or July 3, 2010. Hedge accounting is discontinued if it is determined that the derivative is not highly effective. The Company records all cash flow hedge assets and liabilities on a gross basis as they do not meet the balance sheet netting criteria because the Company does not have master netting agreements established with the derivative counterparties that would allow for net settlement. As of July 2, 2011, the Company had the following outstanding forward contracts that were entered into to hedge the future payments of intercompany inventory transactions (in thousands):

| Type | Functional Currency | Amount | Type | Contract Currency | Amount |
|-------------------|---------------------|-----------|-------------|-------------------|---------|
| European Euro | | 123,958 | U.S. Dollar | | 168,257 |
| British Pound | | 14,629 | U.S. Dollar | | 23,496 |
| Japanese Yen | | 3,679,200 | U.S. Dollar | | 43,159 |
| Mexican Peso | | 32,403 | U.S. Dollar | | 2,660 |
| Australian Dollar | | 15,300 | U.S. Dollar | | 13,420 |
| Canadian Dollar | | 15,727 | U.S. Dollar | | 15,699 |

The effective portion of gains and losses on derivative instruments that was recognized in other comprehensive income (loss), net of taxes, during the Second Quarter and the Prior Year Quarter, Year To Date Period and the Prior Year YTD Period is set forth below (in thousands):

Derivatives Designated as Cash

| Flow Hedges Under ASC 815 | For the 13 Weeks Ended July 2, 2011 | For the 13 Weeks Ended July 3, 2010 |
|---|--|--|
| Foreign exchange contracts | \$ (6,036) | \$ 6,727 |
| Total (loss) gain recognized in other comprehensive income (loss), net of taxes | \$ (6,036) | \$ 6,727 |

Derivatives Designated as Cash

| Flow Hedges Under ASC 815 | For the 26 Weeks Ended July 2, 2011 | For the 26 Weeks Ended July 3, 2010 |
|---|---|---|
| Foreign exchange contracts | \$ (13,129) | \$ 12,635 |
| Total (loss) gain recognized in other comprehensive income (loss), net of taxes | \$ (13,129) | \$ 12,635 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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The following tables illustrate the effective portion of gains and losses on derivative instruments designated and qualifying as cash flow hedges recorded in accumulated other comprehensive income (loss) during the term of the hedging relationship and reclassified into earnings in the periods presented (in thousands). There were no gains and losses on derivatives not designated as hedging instruments recorded directly to earnings during the Second Quarter, Prior Year Quarter, Year To Date Period, and Prior Year YTD Period.

| Foreign Exchange Contracts | Condensed Consolidated | | For the 13 Weeks Ended July 2, 2011 | For the 13 Weeks Ended July 3, 2010 |
|-------------------------------|------------------------|---|-------------------------------------|-------------------------------------|
| | Income Statements | Location | | |
| Under ASC 815 | | | | |
| Cash flow hedging instruments | Other income - net | Total (loss) gain reclassified from other comprehensive income (loss), net of taxes into income, net of taxes | \$ (4,013) | \$ 2,866 |
| Total | | | \$ (4,013) | \$ 2,866 |

| Foreign Exchange Contracts | Condensed Consolidated | | For the 26 Weeks Ended July 2, 2011 | For the 26 Weeks Ended July 3, 2010 |
|-------------------------------|------------------------|---|-------------------------------------|-------------------------------------|
| | Income Statements | Location | | |
| Under ASC 815 | | | | |
| Cash flow hedging instruments | Other income - net | Total (loss) gain reclassified from other comprehensive income (loss), net of taxes into income, net of taxes | \$ (6,259) | \$ 3,178 |
| Total | | | \$ (6,259) | \$ 3,178 |

The following table discloses the Company's fair value amounts as separate asset and liability values, presents the fair value of derivative instruments on a gross basis, and identifies the line item(s) in the condensed consolidated balance sheets in which the fair value amounts for these categories of derivative instruments are included (in thousands):

| Foreign Exchange Contracts Under ASC 815 | Asset Derivatives | | | | Liability Derivatives | | | |
|--|---|------------|---|------------|--------------------------------|------------|--------------------------------|------------|
| | July 2, 2011 | | January 1, 2011 | | July 2, 2011 | | January 1, 2011 | |
| | Condensed Consolidated Balance | Fair Value | Condensed Consolidated Balance | Fair Value | Condensed Consolidated Balance | Fair Value | Condensed Consolidated Balance | Fair Value |
| Cash flow hedging instruments | Prepaid expenses and other current assets | \$ 52 | Prepaid expenses and other current assets | \$ 1,388 | Accrued expenses-other | \$ 15,596 | Accrued expenses-other | \$ 8,583 |

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| | | | | | | | | |
|-------------------------------|-----------------------------------|--------------|-----------------------------------|-----------------|-----------------------------|------------------|-----------------------------|------------------|
| Cash flow hedging instruments | Intangible and other assets - net | 33 | Intangible and other assets - net | 240 | Other long-term liabilities | 879 | Other long-term liabilities | 1,639 |
| Total | | \$ 85 | | \$ 1,628 | | \$ 16,475 | | \$ 10,222 |

At the end of the Second Quarter, the Company had foreign exchange contracts with maturities extending through June 2013. The estimated net amount of the existing gains or losses at the reporting date that is expected to be reclassified into earnings within the next twelve months is a loss of \$13.0 million.

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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7. CONTROLLING AND NONCONTROLLING INTEREST

The following tables summarize the changes in equity attributable to controlling and noncontrolling interest (in thousands):

| | Fossil, Inc. Stockholders Equity | Noncontrolling Interest | Total Stockholders Equity |
|--|--|----------------------------|---------------------------------|
| Balance at January 1, 2011 | \$ 1,044,118 | \$ 7,590 | \$ 1,051,708 |
| Net income | 107,182 | 4,914 | 112,096 |
| Currency translation adjustments | 29,907 | 0 | 29,907 |
| Unrealized loss on securities available for sale | (248) | 0 | (248) |
| Forward contracts hedging intercompany foreign currency payments - change in fair values | (6,870) | 0 | (6,870) |
| Common stock issued upon exercise of stock options and stock appreciation rights | 7,728 | 0 | 7,728 |
| Tax benefit derived from stock-based compensation | 9,333 | 0 | 9,333 |
| Distribution of noncontrolling interest earnings | 0 | (3,772) | (3,772) |
| Common stock forfeitures put to treasury | (5,319) | 0 | (5,319) |
| Acquisition of common stock | (155,350) | 0 | (155,350) |
| Stock-based compensation expense | 5,910 | 0 | 5,910 |
| Balance at July 2, 2011 | \$ 1,036,391 | \$ 8,732 | \$ 1,045,123 |

| | Fossil, Inc. Stockholders Equity | Noncontrolling Interest | Total Stockholders Equity |
|--|--|----------------------------|---------------------------------|
| Balance at January 2, 2010 | \$ 962,781 | \$ 5,631 | \$ 968,412 |
| Net income | 90,392 | 3,863 | 94,255 |
| Currency translation adjustments | (35,191) | 21 | (35,170) |
| Unrealized gain on securities available for sale | 298 | 0 | 298 |
| Unrealized gain on forward contracts | 9,457 | 0 | 9,457 |
| Common stock issued upon exercise of stock options and stock appreciation rights | 9,544 | 0 | 9,544 |
| Tax benefit derived from stock-based compensation | 2,975 | 0 | 2,975 |
| Distribution of noncontrolling interest earnings | 0 | (4,272) | (4,272) |
| Common stock forfeitures put to treasury | (1,910) | 0 | (1,910) |
| Repurchase of common stock | (11,157) | 0 | (11,157) |
| Stock-based compensation expense | 4,500 | 0 | 4,500 |
| Balance at July 3, 2010 | \$ 1,031,689 | \$ 5,243 | \$ 1,036,932 |

FOSSIL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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8. INTANGIBLE AND OTHER ASSETS

The following table summarizes intangible and other assets (in thousands):

| | Useful Lives | July 2, 2011 | | January 1, 2011 | |
|---|-----------------|--------------------|-----------------------------|--------------------|-----------------------------|
| | | Carrying Amount | Accumulated Amortization | Carrying Amount | Accumulated Amortization |
| Intangibles - subject to amortization: | | | | | |
| Trademarks | 10 yrs. | \$ 4,067 | \$ 1,950 | \$ 2,666 | \$ 1,795 |
| Customer list | 9 yrs. | 8,104 | 7,470 | 7,937 | 6,963 |
| Patents | 14 - 20 yrs. | 773 | 372 | 775 | 349 |
| Other | 7 - 20 yrs. | 204 | 203 | 194 | 187 |
| Total intangibles - subject to amortization | | 13,148 | 9,995 | 11,572 | 9,294 |
| Intangibles - not subject to amortization: | | | | | |
| Tradenames | | 18,983 | 0 | 18,938 | 0 |
| Other assets: | | | | | |
| Key money deposits | | 27,164 | 9,701 | 22,973 | 7,720 |
| Other deposits | | 13,207 | 0 | 11,991 | 0 |
| Deferred compensation plan assets | | 3,414 | 0 | 3,295 | 0 |
| Other | | 9,549 | 3,313 | 6,615 | 2,633 |
| Total other assets | | 53,334 | 13,014 | 44,874 | 10,353 |
| Total intangibles and other assets | | \$ 85,465 | \$ 23,009 | \$ 75,384 | \$ 19,647 |
| Total intangibles and other assets, net | | | \$ 62,456 | | \$ 55,737 |

Amortization expense for intangible assets, key money deposits and other assets was approximately \$1.4 million, \$1.1 million, \$2.5 million and \$3.7 million for the Second Quarter, Prior Year Quarter, Year To Date Period and Prior Year YTD Period, respectively. Estimated aggregate future amortization expense, by fiscal year, for intangible assets, key money deposits and other assets is as follows (in thousands):

| | Amortization Expense |
|------------------|-------------------------|
| 2011 (Remaining) | \$ 2,266 |
| 2012 | 4,404 |
| 2013 | 3,643 |
| 2014 | 3,218 |
| 2015 | 2,737 |
| 2016 | 2,426 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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9. COMMITMENTS AND CONTINGENCIES

Leases. On March 7, 2011, the Company entered into a lease of office space and real property at 901 Central Expressway, Richardson, Texas. The lease structure involves two separate lease agreements. The lease agreements commenced on July 1, 2011 and end on June 30, 2021. The Company performed the required lease classification tests and assessed the leases as operating leases. The lease agreements included leasehold improvement incentives which are recorded in deferred rent and will be amortized as reductions to lease expense over the lease term. Leasehold improvements are recorded within property, plant and equipment net and are amortized over the shorter of the economic useful life or the lease term. In addition to the lease obligations disclosed in the notes to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2011, future minimum commitments under these non-cancellable operating leases by fiscal year are as follows (in thousands):

| | Commitments |
|------------------|-------------|
| 2011 (Remaining) | \$ 2,238 |
| 2012 | 5,371 |
| 2013 | 5,371 |
| 2014 | 5,371 |
| 2015 | 5,689 |
| 2016 | 6,005 |
| Thereafter | 27,024 |
| | \$ 57,069 |

Litigation. The Company is occasionally subject to litigation or other legal proceedings in the normal course of its business. The Company does not believe that the outcome of any currently pending legal matters, individually or collectively, will have a material adverse effect on the business or financial condition of the Company.

On August 5, 2011, the Company settled the three shareholder derivative lawsuits that were filed in the United States District Court for the Northern District of Texas, Dallas Division, naming the Company as a nominal defendant and naming all of the Company's then current directors and certain of its current and former officers and directors as defendants. The lawsuits alleged purported violations of federal securities laws and state law claims for breach of fiduciary duty, abuse of control, constructive fraud, corporate waste, unjust enrichment and gross mismanagement in connection with certain stock option grants made by the Company. The settlement provided in part for the following: (i) payment to the Company of approximately \$8.7 million by the insurance carriers for the individual defendants; (ii) the adoption or maintenance by the Company of certain corporate governance measures; and (iii) in payment of plaintiff's counsel's fees and expenses (a) the issuance by the Company to plaintiff's counsel of approximately \$7.8 million in shares of the Company's common stock and (b) the granting to plaintiff's counsel of a stock option to acquire up to 32,000 shares of the Company's common stock. The settlement did not have a material impact on the condensed consolidated financial statements.

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

The following is a discussion of the financial condition and results of operations of Fossil, Inc. and its wholly and majority-owned subsidiaries for the thirteen and twenty-six week periods ended July 2, 2011 (the Second Quarter and Year To Date Period, respectively) as compared to the thirteen and twenty-six week periods ended July 3, 2010 (the Prior Year Quarter and Prior Year YTD Period, respectively). This discussion should be read in conjunction with the condensed consolidated financial statements and the related notes thereto.

General

We are a global design, marketing and distribution company that specializes in consumer fashion accessories. Our principal offerings include an extensive line of men's and women's fashion watches and jewelry, handbags, small leather goods, belts, sunglasses, soft accessories, shoes and clothing. In the watch and jewelry product category, our offerings include a diverse portfolio of globally recognized owned and licensed brand names under which our products are marketed. Our products are distributed globally through various distribution channels including wholesale in countries where we have a physical presence, direct to the consumer through our retail stores and commercial websites and through third-party distributors in countries where we do not maintain a physical presence. Our products are offered at varying price points to service the needs of our customers, whether they are value-conscious or luxury oriented. Based on our extensive range of accessory products, brands, distribution channels and price points, we are able to target style-conscious consumers across a wide age spectrum on a global basis.

Domestically, we sell our products through a diversified distribution network that includes department stores, specialty retail locations, specialty watch and jewelry stores, owned retail and factory outlet stores, mass market stores and through our FOSSIL® catalog and website. Our wholesale customer base includes, among others, Neiman Marcus, Nordstrom, Saks Fifth Avenue, Macy's, Dillard's, JCPenney, Kohl's, Sears, Wal-Mart and Target. We also sell our products in the United States through a network of Company-owned stores that included 116 retail stores located in premier retail sites and 72 outlet stores located in major outlet malls as of July 2, 2011. In addition, we offer an extensive collection of our FOSSIL brand products through our catalogs and on our website, www.fossil.com, as well as proprietary and licensed watch and jewelry brands through other managed and affiliated websites.

Internationally, our products are sold to department stores, specialty retail stores and specialty watch and jewelry stores in approximately 120 countries worldwide through 23 Company-owned foreign sales subsidiaries and through a network of approximately 60 independent distributors. Our products are distributed in Africa, Asia, Australia, Europe, Central and South America, Canada, the Caribbean, Mexico and the Middle East. Our products are offered on airlines, cruise ships and in international Company-owned retail stores, which included 156 retail stores located in premier retail sites and 23 outlet stores in select international markets as of July 2, 2011. Our products are also sold through licensed and franchised FOSSIL retail stores and kiosks in certain international markets. In addition, we offer an extensive collection of our FOSSIL brand products on our websites in certain countries.

Our business is subject to global economic cycles and retail industry conditions. Purchases of discretionary fashion accessories, such as our watches, handbags, sunglasses and other products, tend to decline during recessionary periods when disposable income is low and consumers are hesitant to use available credit. If economic conditions worsen or if the global or regional economies slip back into a recession, our revenues and earnings for fiscal year 2011 or beyond could be negatively impacted.

Our business is also subject to the risks inherent in global sourcing of supply. Certain key components in our products come from sole or limited sources of supply, which exposes us to potential supply shortages that could disrupt the manufacture and sale of our products. Any interruption or delay in the supply of key components could significantly harm our ability to meet scheduled product deliveries to our customers and cause us to lose sales. Interruptions or delays in supply may be caused by a number of factors that are outside of our and our contractor manufacturers control, such as natural disasters like the earthquake and tsunami in Japan.

Future sales and earnings growth are also contingent upon our ability to anticipate and respond to changing fashion trends and consumer preferences in a timely manner while continuing to develop innovative products in the respective markets in which we compete. As is typical with new products, market acceptance of new designs and products that we may introduce is subject to uncertainty. In addition, we generally make decisions regarding product designs several months in advance of the time when consumer acceptance can be measured. We believe the double-digit net sales growth we have experienced over the last several fiscal quarters is a result of our ability to design innovative watch products incorporating a number of new materials that not only differentiate us from our competition but also continues to provide a solid value proposition to consumers across all of our brands.

The majority of our products are sold at price points ranging from \$50 to \$600. Although the current economic environment continues to weigh on consumer discretionary spending levels, we believe that the price/value relationship and the differentiation and innovation of our products, in comparison to those of our competitors, will allow us to maintain or grow our market share in those markets in which we compete. Historically, during recessionary periods, the strength of our balance sheet, our strong operating cash flow and the relative size of our business with our wholesale customers, in comparison to that of our competitors, have allowed us to weather recessionary periods for longer periods of time and generally resulted in market share gains to us.

Our international operations are subject to many risks, including foreign currency. Generally, a strengthening of the U.S. dollar against currencies of other countries in which we operate will reduce the translated amounts of sales and operating expenses of our subsidiaries, which results in a reduction of our consolidated operating income. We manage these currency risks by using derivative instruments. The primary risks managed by using derivative instruments are the future payments of intercompany inventory transactions, denominated in U.S. dollars, by non-U.S. subsidiaries. We enter into forward contracts to manage fluctuations in global currencies that will ultimately be used to settle such U.S. dollar denominated inventory purchases.

For a more complete discussion of the risks facing our business, see Part I, Item 1A. Risk Factors of our Annual Report on Form 10-K for the fiscal year ended January 1, 2011.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to product returns, bad debt, inventories, long-lived asset impairment, impairment of goodwill and trade names, income taxes, warranty costs, hedge accounting, litigation reserves and stock-based compensation. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances. Our estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. There have been no changes to the critical accounting policies disclosed in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011.

Results of Operations

The following tables set forth, for the periods indicated, (i) the percentages of our net sales represented by certain line items from our condensed consolidated statements of income and comprehensive income and (ii) the percentage changes in these line items between the periods indicated.

| | Percentage of Net Sales For the 13 Weeks Ended | | Percentage Change |
|--|---|--------------|----------------------|
| | July 2, 2011 | July 3, 2010 | from 2010 |
| Net sales | 100.0% | 100.0% | 34.9% |
| Cost of sales | 44.0 | 42.6 | 39.3 |
| Gross profit | 56.0 | 57.4 | 31.7 |
| Operating expenses: | | | |
| Selling and distribution | 29.5 | 31.3 | 27.4 |
| General and administrative | 11.0 | 10.5 | 41.0 |
| Operating income | 15.5 | 15.6 | 34.1 |
| Interest expense | 0.1 | 0.0 | * |
| Other (expense) income - net | (0.7) | 0.0 | * |
| Income before income taxes | 14.7 | 15.6 | 26.6 |
| Provision for income taxes | 5.0 | 1.9 | 247.2 |
| Net income | 9.7 | 13.7 | (4.5) |
| Net income attributable to noncontrolling interest, net of taxes | 0.5 | 0.5 | 28.7 |
| Net income attributable to Fossil, Inc. | 9.2% | 13.2% | (5.7)% |

* Not meaningful.

| | Percentage of Net Sales For the 26 Weeks Ended | | Percentage Change |
|------------------------------|---|--------------|----------------------|
| | July 2, 2011 | July 3, 2010 | from 2010 |
| Net sales | 100.0% | 100.0% | 35.7% |
| Cost of sales | 43.9 | 43.4 | 37.3 |
| Gross profit | 56.1 | 56.6 | 34.5 |
| Operating expenses: | | | |
| Selling and distribution | 29.5 | 31.5 | 27.1 |
| General and administrative | 10.2 | 10.8 | 29.2 |
| Operating income | 16.4 | 14.3 | 54.7 |
| Interest expense | 0.1 | 0.0 | * |
| Other (expense) income - net | (0.7) | 0.4 | * |
| Income before income taxes | 15.6 | 14.7 | 44.5 |
| Provision for income taxes | 5.4 | 3.0 | 145.1 |

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| | | | |
|--|------|-------|-------|
| Net income | 10.2 | 11.7 | 18.9 |
| Net income attributable to noncontrolling interest, net of taxes | 0.4 | 0.5 | 27.2 |
| Net income attributable to Fossil, Inc. | 9.8% | 11.2% | 18.6% |

* Not meaningful.

Net Sales. The following tables set forth consolidated net sales by segment and the percentage relationship of each segment to consolidated net sales for the periods indicated (in millions, except percentage data):

| | Amounts For the 13 Weeks Ended | | Percentage of Total For the 13 Weeks Ended | |
|------------------------|-----------------------------------|-----------------|---|---------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| Wholesale: | | | | |
| North America | \$ 213.1 | \$ 155.9 | 38.3% | 37.8% |
| Europe | 141.8 | 107.7 | 25.4 | 26.1 |
| Asia Pacific | 67.9 | 46.4 | 12.2 | 11.2 |
| Total wholesale | 422.8 | 310.0 | 75.9 | 75.1 |
| Direct to consumer | 133.9 | 102.6 | 24.1 | 24.9 |
| Total net sales | \$ 556.7 | \$ 412.6 | 100.0% | 100.0% |

| | Amounts For the 26 Weeks Ended | | Percentage of Total For the 26 Weeks Ended | |
|------------------------|-----------------------------------|-----------------|---|---------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| Wholesale: | | | | |
| North America | \$ 419.8 | \$ 309.7 | 38.4% | 38.4% |
| Europe | 293.6 | 220.2 | 26.8 | 27.3 |
| Asia Pacific | 132.1 | 85.1 | 12.1 | 10.6 |
| Total wholesale | 845.5 | 615.0 | 77.3 | 76.3 |
| Direct to consumer | 248.1 | 190.8 | 22.7 | 23.7 |
| Total net sales | \$ 1,093.6 | \$ 805.8 | 100.0% | 100.0% |

The following tables illustrate by factor the total year-over-year percentage change in net sales by segment and on a consolidated basis:

Analysis of Percentage Change in Net Sales during the Second Quarter Versus Prior Year Quarter

Attributable to Changes in the Following Factors

| | Exchange Rates | Organic Change | Total Change |
|-------------------------|-------------------|-------------------|--------------|
| North America wholesale | 0.7% | 36.0% | 36.7% |
| Europe wholesale | 14.9 | 16.8 | 31.7 |
| Asia Pacific wholesale | 11.0 | 35.3 | 46.3 |
| Direct to consumer | 4.8 | 25.7 | 30.5 |
| Consolidated | 6.5% | 28.4% | 34.9% |

Analysis of Percentage Change in Net Sales during the Year To Date Period Versus Prior Year YTD Period

Attributable to Changes in the Following Factors

| | Exchange Rates | Organic Change | Total Change |
|-------------------------|-------------------|-------------------|--------------|
| North America wholesale | 0.6% | 35.0% | 35.6% |
| Europe wholesale | 7.5 | 25.8 | 33.3 |

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| | | | |
|------------------------|------|-------|-------|
| Asia Pacific wholesale | 9.8 | 45.4 | 55.2 |
| Direct to consumer | 3.2 | 26.8 | 30.0 |
| Consolidated | 4.1% | 31.6% | 35.7% |

The following net sales discussion excludes the impact on sales growth attributable to foreign currency rate changes as noted in the above tables.

Consolidated Net Sales. We believe watch sales across all of our operating segments are benefiting from a trend toward consumers allocating more of their discretionary spending to this fashion category. We believe the watch category in general has experienced a resurgence over the last eighteen months across many of the markets in which we distribute. We also believe our results are outpacing those of our competitors as a result of the consumers' positive response to our innovative product offerings. We believe our designs which incorporate newer materials within the construction of the watch while also maintaining a very strong price

to value relationship are driving consumers to purchase our branded offerings. With respect to the FOSSIL brand, we believe our strategy of focusing our marketing efforts on point-of-sale presentations, our catalog and web-based marketing initiatives as well as the growth of our Fossil store and e-commerce footprint is clearly communicating the aspirational lifestyle image of the brand and is resonating strongly with consumers around the world. Net sales of FOSSIL branded products increased by 17.2% and 18.2% during the Second Quarter and Year To Date Period, respectively, as compared to the prior fiscal year periods.

North America Wholesale Net Sales. In the Second quarter, net sales from our North America wholesale segment rose 36.0%, or \$56.2 million, in comparison to the Prior Year Quarter. This sales growth was largely a result of a \$45.2 million, or 40.7%, increase in watch sales. During the Second Quarter, all major watch brands experienced sales volume growth in North America with the greatest gain occurring in MICHAEL KORS®, \$22.6 million. MICHAEL KORS sales volumes benefited from increased penetration at existing customers as retailers in the department store channel continued to increase case space allocated to the brand due to increased sell-through rates. Sales to foreign distributors, located primarily in Latin America and to a lesser extent the Caribbean, also favorably impacted the Second Quarter as sales volumes increased 64.4%, or \$10.2 million. Additionally, our leathers business contributed to the sales volume growth during the Second Quarter, increasing 27.8%, or \$9.4 million. This sales growth was principally driven by increased sell-through rates of women's handbags and small leather products at retail, which led to increased orders from our department store customers. For the Year To Date Period, North America wholesale net sales increased 35.0%, or \$108.4 million, as compared to the Prior Year YTD Period. This increase was principally driven by the same brands and categories as experienced during the Second Quarter.

Europe Wholesale Net Sales. Europe wholesale net sales increased 16.8%, or \$18.2 million, during the Second Quarter as compared to the Prior Year Quarter. During the Second Quarter, all major watch brands experienced sales growth in Europe, resulting in an 18.5%, or \$14.3 million, increase in watch sales. Slight inventory delays on certain core styles resulted in a shift of European sales out of the Second Quarter and into the third quarter of fiscal year 2011. As a result, Europe wholesale shipments increased by more than 35% in July 2011, as compared to the prior year month. During the Second Quarter the largest sales volume gains were experienced in MICHAEL KORS, \$4.9 million, BURBERRY®, \$2.4 million, DKNY®, \$2.3 million, FOSSIL, \$2.0 million and EMPORIO ARMANI®, \$1.9 million. The Second Quarter also benefited from a 55.9%, or \$10.0 million, increase in sales to third party distributors, primarily located in Eastern Europe and the Middle East. Additionally, leathers and jewelry sales volume growth of 64.1%, or \$3.1 million and 2.7%, or \$0.5 million, respectively, favorably impacted overall Europe wholesale sales growth during the Second Quarter. We believe the growth experienced in our leathers business was a result of our initiative to expand our leather offerings in the wholesale channel and the increased brand awareness generated by the expansion of our FOSSIL accessory store concept in this region. Europe wholesale net sales increased 25.8%, or \$56.9 million, for the Year To Date Period as compared to the Prior Year YTD Period. The primary components of the increase, other than the growth of the jewelry category during the Year To Date Period, were generally consistent from a brand and category perspective with those experienced during the Second Quarter.

Asia Pacific Wholesale Net Sales. Asia Pacific wholesale net sales rose 35.3%, or \$16.4 million, during the Second Quarter in comparison to the Prior Year Quarter, primarily as a result of a 40.5%, or \$16.2 million, increase in watch sales and, to a lesser extent, a 38.8%, or \$1.0 million, increase in leathers sales. These increases were partially offset by a 43.2%, or \$1.1 million, decrease in our jewelry business. All major watch brands experienced growth in the Asia Pacific region during the Second Quarter, led by EMPORIO ARMANI, \$4.9 million and MARC BY MARC®, \$4.3 million. Sales growth across the Asia Pacific region benefited from an increased mix of sales at full retail through Company-owned concessions, including substantial growth from our South Korean concession business. Similar to our experience in Europe, we believe the sales growth in our leathers business was a result of increased brand awareness generated by the expansion of our FOSSIL accessory store concept and our initiative to expand our leather business in the wholesale channel in the Asia Pacific region. The sales decrease in our jewelry business was primarily the result of discontinuing a non-strategic local jewelry brand in India. Excluding Japan results for the comparable periods, due to the negative impact the natural disaster occurring in first quarter fiscal year 2011 had on our Second Quarter shipments, and excluding certain non-branded, non-licensed businesses, we have or are discontinuing, net sales in the Asia Pacific region increased 47.2% during the Second Quarter. For the Year To Date Period as compared to the Prior Year YTD Period, Asia Pacific wholesale net sales rose 45.4%, or \$38.6 million, principally as a result of the same factors experienced during the Second Quarter.

Direct to Consumer Net Sales. Direct to consumer net sales for the Second Quarter increased 25.7%, or \$26.4 million, in comparison to the Prior Year Quarter, primarily the result of comparable store sales gains of 22.0% and a 2.8% increase in the average number of company-owned stores open during the Second Quarter. Additionally, net sales from our e-commerce businesses increased 20.2%, or \$1.4 million, during the Second Quarter in comparison to the Prior Year Quarter. For the Year To Date Period, net sales from our direct to consumer segment increased 26.8%, or \$51.2 million, in comparison to the Prior Year YTD Period, primarily as a result of a 5.6% increase in the average number of stores open and comparable store sales increases of 21.7%. Net sales from our e-commerce businesses increased 23.4%, or \$3.3 million, for the Year To Date Period in comparison to the Prior Year YTD Period. Comparable store sales related to our global full price accessory concept increased by 16.2% and 15.5% for the Second Quarter and Year To Date Period, respectively. Global outlet comparable store sales increased 29.8% and 30.5% for the Second Quarter and Year To Date Period, respectively.

We ended the Second Quarter with 367 stores, including 235 full price accessory stores, 132 of which were outside of North America, 95 outlet locations, including 22 outside of North America, 27 clothing stores, including three outside of North America, and

10 full price multi-brand stores, including nine outside of North America. This compares to 354 stores at the end of the Prior Year Quarter, which included 222 full price accessory stores, 120 located outside of North America, 88 outlet locations, including 17 outside of North America, 31 clothing stores, including two outside of North America, and 13 full price multi-brand stores, including 12 outside of North America. During the Second Quarter, we opened nine new stores and closed four. For fiscal year 2011, we anticipate opening approximately 58 to 62 additional retail stores globally and closing 20 stores.

A store is included in comparable store sales in the thirteenth month of operation. Stores that experience a gross square footage increase of 10% or more due to an expansion and/or relocation are removed from the comparable store sales base, but are included in total sales. These stores are returned to the comparable store sales base in the thirteenth month following the expansion and/or relocation.

Gross Profit. Gross profit of \$312.0 million in the Second Quarter represented a 31.7% increase from \$236.9 million in the Prior Year Quarter. The increase was a result of increased net sales partially offset by a reduction in gross profit margin. Gross profit margin decreased 140 basis points to 56.0% in the Second Quarter from 57.4% in the Prior Year Quarter, inclusive of a 150 basis point favorable impact stemming from a weaker U.S. dollar. The decrease in gross profit margin was primarily driven by production cost increases and to a lesser extent, a larger percentage of lower margin product sales in the sales mix. Increased production costs were primarily related to a rise in certain watch component costs as well as increased factory labor rates in China. During the current fiscal year, we have experienced a 32% increase in labor rates in our China-based watch factories. Additionally, lower margin U.S. wholesale sales, sales to third party distributors and off-price retailers increased as a percentage of the sales mix, negatively impacting gross profit margin. For the Year To Date Period, gross profit margin decreased by 50 basis points to 56.1% compared to 56.6% in the Prior Year YTD Period. As a result of rising labor rates and component costs, we will experience year over year, as well as sequential, margin deterioration during the third quarter. We estimate third quarter gross margins just above 55%. We expect fourth quarter margins to be in line with the prior fiscal year, but lower than our previous guidance, as the impact of newness and a higher mix of direct to consumer and higher margin Asia Pacific wholesale sales are expected to partially offset ongoing labor and material cost increases.

Operating Expenses. Operating expenses, expressed as a percentage of net sales, decreased to 40.5% in the Second Quarter compared to 41.8% in the Prior Year Quarter. Total operating expenses in the Second Quarter increased by \$53.2 million from the Prior Year Quarter primarily as a result of increased costs associated with sales growth and a \$12.4 million unfavorable impact from the translation of foreign-based expenses due to a weaker U.S. dollar. During the Second Quarter, on a constant dollar basis, operating expenses in the Company's wholesale segments and corporate cost areas increased \$17.7 million and \$10.7 million, respectively, as compared to the Prior Year Quarter. Expense growth in the wholesale segments included approximately \$4.7 million of strategic spend in the Asia Pacific region along with increased payroll costs and marketing expenses in the North America and Europe wholesale segments. Expense growth in the corporate cost areas was primarily associated with increased payroll costs, including stock compensation, professional services and costs associated with our planned move to a new headquarters building during the third quarter of fiscal year 2011. During the Second Quarter, operating expenses in the direct to consumer segment rose by \$12.4 million as compared to the Prior Year Quarter, primarily due to store growth, the launch of our customer relationship management initiative, expansion of catalog mailings and increased web-based marketing and infrastructure expenditures. For the Year To Date Period, operating expenses as a percentage of net sales decreased to 39.8% compared to 42.3% in the Prior Year YTD Period and included a \$15.7 million unfavorable impact from the translation of foreign-based expenses due to a weaker U.S. dollar. On a constant dollar basis, operating expenses for the Year To Date Period increased by \$78.5 million as compared to Prior Year YTD Period, with increases across all of the Company's operating segments, primarily the result of the same factors experienced during the Second Quarter.

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The following tables set forth operating expenses on a segment basis and the relative percentage of operating expenses to net sales for each segment for the periods indicated (in millions, except for percentage data):

| | For the 13 Weeks Ended July 2, 2011 | | For the 13 Weeks Ended July 3, 2010 | |
|-------------------------|-------------------------------------|----------------|-------------------------------------|----------------|
| | Operating Expense | % of Net Sales | Operating Expense | % of Net Sales |
| North America wholesale | \$ 34.9 | 16.4% | \$ 30.5 | 19.6% |
| Europe wholesale | 47.2 | 33.3 | 35.3 | 32.8 |
| Asia Pacific wholesale | 31.8 | 46.8 | 21.9 | 47.2 |
| Direct to consumer | 74.6 | 55.7 | 58.9 | 57.4 |
| Corporate | 37.2 | | 25.9 | |
| Total | \$ 225.7 | 40.5% | \$ 172.5 | 41.8% |

| | For the 26 Weeks Ended July 2, 2011 | | For the 26 Weeks Ended July 3, 2010 | |
|-------------------------|-------------------------------------|----------------|-------------------------------------|----------------|
| | Operating Expense | % of Net Sales | Operating Expense | % of Net Sales |
| North America wholesale | \$ 75.3 | 17.9% | \$ 62.6 | 20.2% |
| Europe wholesale | 91.8 | 31.3 | 72.2 | 32.8 |
| Asia Pacific wholesale | 61.1 | 46.3 | 42.2 | 49.6 |
| Direct to consumer | 143.5 | 57.8 | 114.2 | 59.9 |
| Corporate | 63.3 | | 49.5 | |
| Total | \$ 435.0 | 39.8% | \$ 340.7 | 42.3% |

Operating Income. Operating income increased \$21.9 million, or 34.1%, in the Second Quarter compared to the Prior Year Quarter. As a percentage of net sales, operating income remained relatively unchanged at 15.5% of net sales in the Second Quarter compared to 15.6% of net sales in the Prior Year Quarter. In the Second Quarter, increased net sales and lower operating expenses as a percentage of net sales were offset by lower gross profit margins. During the Second Quarter, operating income was positively impacted by approximately \$10.8 million as a result of the translation of foreign-based sales and expenses into U.S. dollars. During the Year To Date Period, operating income margin increased to 16.4% as compared to 14.3% in the Prior Year YTD Period. Operating income for the Year To Date Period included approximately \$16.4 million of net currency gains related to the translation of foreign-based sales and expenses into U.S. dollars.

Other (Expense) Income - Net. Other (expense) income net decreased unfavorably by \$4.2 million and \$9.8 million during the Second Quarter and Year To Date Period, respectively, in comparison to the prior fiscal year periods. These decreases were primarily driven by unfavorable foreign currency charges resulting from mark-to-market, hedging and other transactional activities during the Second Quarter and Year To Date Period in comparison to the respective prior fiscal year periods. At prevailing foreign currency exchange rates, we estimate that outstanding forward contracts with scheduled settlement dates in the second half of fiscal year 2011 would result in hedge losses of approximately \$5.1 million and \$6.3 million in the third and fourth quarters of fiscal 2011, respectively.

Provision For Income Taxes. Income tax expense for the Second Quarter was \$27.7 million, resulting in an effective income tax rate of 33.9%. For the Prior Year Quarter, income tax expense was \$8.0 million, resulting in an effective income tax rate of 12.3%. Included in the 12.3% effective tax rate for the Prior Year Quarter was a 21.8% rate reduction from our structural tax rate related to the recognition of previously unrecognized tax benefits as a result of audit settlements. Income tax expense was \$58.9 million for the Year To Date Period, resulting in an effective tax rate of 34.4%. For the Prior Year YTD Period, income tax expense was \$24.0 million, resulting in an effective tax rate of 20.3%. We estimate our effective tax rate for the third and fourth quarters of fiscal 2011 will approximate 35%, excluding any discrete events.

Net Income Attributable to Noncontrolling Interest. Net income attributable to noncontrolling interest, which represents the minority interest portion of subsidiaries in which we own less than 100%, increased by \$0.6 million and \$1.1 million for the Second Quarter and Year To Date Period, respectively, as compared to the prior fiscal year periods. These increases were primarily a result of increased net income related to our less than 100% owned watch assembly facilities.

Net Income Attributable to Fossil, Inc. Second Quarter net income attributable to Fossil, Inc. decreased by 5.7% to \$51.4 million, or \$0.80 per diluted share, inclusive of a favorable \$0.07 per diluted share increase related to foreign currency. Net income attributable to Fossil, Inc. of \$107.2 million, or \$1.66 per diluted share, for the Year To Date Period represented an 18.6% increase compared to the \$90.4 million, or \$1.33 per diluted share, earned during the Prior Year YTD Period. Net income attributable to Fossil, Inc. for the Year To Date Period included net

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foreign currency gains of \$0.07 per diluted share. The net income attributable to Fossil, Inc. for the Prior Year Quarter and Prior Year YTD Period included a benefit of \$0.22 and \$0.26 per diluted share, respectively, as a result of the aforementioned reduction in certain income tax liabilities.

2011 Net Sales and Earnings Estimates. For the third and fourth quarters of 2011, we expect reported net sales to increase in a range of 22% to 24% with constant dollar net sales increasing in a range of 18% to 20%. Third quarter 2011 diluted earnings per share are expected to be in a range of \$1.00 to \$1.03. Fourth quarter 2011 diluted earnings per share are expected to be in a range of \$1.78 to \$1.82. This guidance results in estimated fiscal year 2011 diluted earnings per share in a range of \$4.44 to \$4.50 compared to fiscal year 2010 actual diluted earnings per share of \$3.77. Our forward guidance is based upon the current prevailing rate of the U.S. dollar compared to other foreign currencies for countries in which we operate.

Liquidity and Capital Resources

Historically, our general business operations have not required substantial cash during the first several months of our fiscal year. Generally, starting in the second quarter, our cash needs begin to increase, typically reaching a peak in the September-November time frame as we increase inventory levels in advance of the holiday season. Our quarterly cash requirements are also impacted by the number of new stores we open, other capital expenditures and the amount of any discretionary stock repurchases we make. Our cash and cash equivalent balance as of the end of the Second Quarter was \$323.5 million in comparison to \$434.5 million at the end of the Prior Year Quarter and \$392.8 million at the end of fiscal year 2010.

Net cash provided by operating activities of \$83.2 million was more than offset by net cash used in investing and financing activities of \$15.8 million and \$138.7 million, respectively. Net cash provided by operating activities consisted of net income of \$112.1 million and favorable non-cash activities of \$32.5 million, partially offset by decreases in working capital of \$61.4 million. Net cash used in investing activities was primarily driven by \$30.4 million in capital expenditures partially offset by proceeds from the sale of property, plant and equipment of \$21.3 million, primarily relating to the sale of three corporate office buildings. Net cash used in financing activities was principally the result of \$155.4 million of common stock repurchases.

Accounts receivable increased by 38.8% to \$226.1 million at the end of the Second Quarter compared to \$162.9 million at the end of the Prior Year Quarter, primarily due to an increase in wholesale shipments during the Second Quarter versus the Prior Year Quarter. Days sales outstanding for our wholesale segments for the Second Quarter was 47 days in comparison to 46 days in the Prior Year Quarter. Inventory at the end of the Second Quarter was \$450.7 million, representing an increase of 51.5% from the Prior Year Quarter inventory balance of \$297.5 million. Higher inventory levels resulted from continued smoothing of factory production throughout the Year To Date Period which resulted in increased inventory levels in the first half of fiscal year 2011 due to sales being seasonally higher in the second half of the fiscal year. We expect inventory increases to slow over the balance of the fiscal year with projected fiscal year-end inventory growth in line with sales growth.

In fiscal year 2010, our Board of Directors approved two common stock repurchase programs pursuant to which up to \$30 million and \$750 million, respectively, could be used to repurchase outstanding shares of our common stock. Both of these repurchase programs are to be conducted pursuant to Rule 10b-18 of the Securities Exchange Act of 1934. The \$750 million repurchase program has a termination date of December 2013 and the \$30 million repurchase program has no termination date. We repurchased 3.1 million shares under the \$750 million repurchase program during fiscal year 2010 at a cost of \$179.2 million. During the Year To Date Period, we repurchased 1.9 million shares under the \$750 million repurchase program at a cost of \$155.4 million of which 0.6 million shares were repurchased during the Second Quarter at cost of \$60.9 million.

At the end of the Second Quarter, we had working capital of \$805.4 million compared to working capital of \$788.8 million at the end of the Prior Year Quarter. Additionally, at the end of the Second Quarter, we had approximately \$8.9 million of outstanding short-term borrowings and \$4.8 million in long-term debt.

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On December 17, 2010, we and certain of our subsidiaries entered into a Credit Agreement (the "Credit Agreement") with Wells Fargo Bank, National Association ("Wells Fargo"), as administrative agent, swingline lender and issuing lender, Wells Fargo Securities, LLC, as sole lead arranger and sole book manager, and Bank of America, N.A., as lender. The Credit Agreement provides for revolving credit loans in the amount of \$300 million (the "Revolver"), a swingline loan of \$20 million, and the provision for letters of credit. We had no outstanding borrowings under the Revolver at the end of the Second Quarter. Amounts outstanding under the Revolver bear interest at our option of (i) the base rate (defined as the higher of (a) the prime rate publicly announced by Wells Fargo, (b) the federal funds rate plus 1.50% and (c) LIBOR plus 1.50%) plus the base rate applicable margin (which varies based upon our consolidated leverage ratio (the "Ratio") from 0.25% if the Ratio is less than 1.00 to 1.00, to 1.00% if the Ratio is greater than or equal to 2.00 to 1.00) or (ii) the LIBOR rate (defined as the quotient obtained by dividing (a) LIBOR by (b) 1.00 minus the Eurodollar reserve percentage) plus the LIBOR rate applicable margin (which varies based upon the Ratio from 1.25% if the Ratio is less than 1.00 to 1.00 to 2.00% if the Ratio is greater than or equal to 2.00 to 1.00). Amounts outstanding under the swingline loan under the Credit Agreement or upon any drawing under a letter of credit bear interest at the base rate plus the base rate applicable margin. We had \$1.4 million of outstanding standby letters of credit at July 2, 2011 that reduce amounts available under the Revolver.

In December 2010, our Japanese subsidiary, Fossil Japan, Inc. (Fossil Japan), entered into a new 400 million Yen short-term credit facility agreement (the Facility). At June 30, 2011, Fossil Japan paid off the 400 million Yen balance allowing the Facility to expire with no renewal.

At the end of the Second Quarter, we had approximately \$4.8 million of outstanding long-term borrowings, of which \$4.3 million was related to our wholly-owned subsidiary, Fossil Group Europe, GmbH, in the form of a term note. This note has a variable interest term with an interest rate at the end of the Second Quarter of 2.0% with interest payments due quarterly. This note requires minimum principal payments of 100,000 Swiss Francs each year with no stated maturity and no penalties for early termination.

On April 6, 2011, our Korean subsidiary, Fossil (Korea) Limited (Fossil Korea), entered into a new \$20 million credit facility agreement (the Agreement) with Bank of America, N.A., Seoul Branch. The Agreement bears interest, based on a three month CD rate which is published by the Korea Securities Dealers Association, plus 120 basis points for a one month period or plus 130 basis points for a three month period. On April 22, 2011, Fossil Korea borrowed 11 billion Won, or \$10.1 million, at an interest rate of 4.6%, with such amounts used primarily to reduce certain intercompany loans and payables. On May 23, 2011, Fossil Korea paid 2 billion Won, or \$1.8 million, toward the outstanding principal. As of July 2, 2011, Fossil Korea had an outstanding balance of 9 billion Won, or \$8.4 million, at an interest rate of 4.76%.

At July 2, 2011, we were in compliance with all debt covenants related to all of our credit facilities. We believe that cash flows from operations combined with existing cash on hand will be sufficient to fund our working capital needs, common stock repurchases and planned capital expenditures for the next twelve months. We also have access to amounts available under our credit facilities should additional funds be required.

Contractual Obligations

On March 7, 2011, we entered into a lease of office space and real property at 901 Central Expressway, Richardson, Texas. The lease structure involves two separate lease agreements. The lease agreements commenced on July 1, 2011 and end on June 30, 2021. We performed the required lease classification tests and assessed the leases as operating leases. The lease agreements included leasehold improvement incentives which are recorded in deferred rent and will be amortized as reductions to lease expense over the lease term. In addition to the lease obligations disclosed in the notes to the consolidated financial statements included in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011, future minimum commitments under these non-cancellable operating leases by fiscal year are as follows (in thousands):

| | Commitments |
|------------------|--------------------|
| 2011 (Remaining) | \$ 2,238 |
| 2012 | 5,371 |
| 2013 | 5,371 |
| 2014 | 5,371 |
| 2015 | 5,689 |
| 2016 | 6,005 |
| Thereafter | 27,024 |
| | \$ 57,069 |

Forward-Looking Statements

The statements contained and incorporated by reference in this Quarterly Report on Form 10-Q that are not historical facts, including, but not limited to, statements regarding our expected financial position, results of operations, business and financing plans found in this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 3. Quantitative and Qualitative Disclosures About Market Risk, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and involve a number of risks and uncertainties. The words may, believes, expects, plans, intends, estimates, anticipates and similar expressions identify forward-looking statements. The actual results of the future events described in such forward-looking statements could differ materially from those stated in such forward-looking statements. Among the factors that could cause actual results to differ materially are: the effect of worldwide economic conditions; significant changes in consumer spending patterns or preferences; acts of war or acts of terrorism; changes in foreign currency valuations in relation to the U.S. dollar; lower levels of consumer spending resulting from a general economic downturn or generally reduced shopping activity caused by public safety or consumer confidence concerns; the performance of our products within the prevailing retail environment; customer acceptance of both new designs and newly-introduced product lines; financial difficulties encountered by customers; the effects of vigorous competition in the markets in which we operate; the integration of the organizations and operations of any acquired businesses into our existing organization and operations; the termination or non-renewal of material licenses, foreign operations and manufacturing; changes in the costs of materials, labor and advertising; government regulation; our ability to secure and protect trademarks and

other intellectual property rights; and the outcome of current and possible future litigation.

In addition to the factors listed above, our actual results may differ materially due to the other risks and uncertainties discussed in this Quarterly Report on Form 10-Q and the risks and uncertainties set forth in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011. Accordingly, readers of this Quarterly Report on Form 10-Q should consider these facts in evaluating the information and are cautioned not to place undue reliance on the forward-looking statements contained herein. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a multinational enterprise, we are exposed to changes in foreign currency exchange rates. Our most significant foreign currency risks relate to the European Euro, and to a lesser extent, the British Pound, the Swiss Franc, the Australian Dollar, Canadian Dollar, Japanese Yen, Korean Won, Mexican Peso, Malaysian Ringgit, Singapore Dollar and Swedish Krona as compared to the U.S. dollar. Due to our vertical nature whereby a significant portion of goods are sourced from our owned facilities, the foreign currency risks relate primarily to the necessary current settlement of intercompany inventory transactions. We employ a variety of operating practices to manage these market risks relative to foreign currency exchange rate changes and, where deemed appropriate, utilize foreign currency forward contracts. These operating practices include, among others, our ability to convert foreign currency into U.S. dollars at spot rates and to maintain U.S. dollar pricing relative to sales of our products to certain distributors located outside the U.S. The use of foreign currency forward contracts allows us to offset exposure to rate fluctuations because the gains or losses incurred on the derivative instruments will offset, in whole or in part, losses or gains on the underlying foreign currency exposure. We use

derivative instruments only for risk management purposes and do not use them for speculation or for trading. There were no significant changes in how we managed foreign currency transactional exposure in the Second Quarter, and we do not anticipate any significant changes in such exposures or in the strategies we employ to manage such exposure in the near future.

At the end of the Second Quarter, we had outstanding foreign exchange contracts to sell 124.0 million European Euros for approximately \$168.3 million, expiring through December 2012, 14.6 million British Pounds for approximately \$23.5 million, expiring through December 2012, 3.7 billion Japanese Yen for approximately \$43.2 million, expiring through June 2013, 15.3 million Australian Dollars for approximately \$13.4 million, expiring through May 2012, 32.4 million Mexican Pesos for approximately \$2.7 million, expiring through December 2011, and 15.7 million Canadian Dollars for approximately \$15.7 million, expiring through December 2012. If we were to settle our European Euro, British Pound, Japanese Yen, Australian Dollar, Mexican Peso and Canadian Dollar based contracts at July 2, 2011, the net result would have been a net loss of approximately \$13.7 million, net of taxes.

At the end of the Second Quarter, a 10% unfavorable change in the U.S. dollar strengthening against foreign currencies to which we have balance sheet transactional exposures, would have decreased net pre-tax income by \$10.8 million. The translation of the balance sheets of our foreign-based operations from their local currencies into U.S. dollars is also sensitive to changes in foreign currency exchange rates. At the end of the Second Quarter, a 10% unfavorable change in the exchange rate of the U.S. dollar strengthening against the foreign currencies to which we have exposure would have reduced consolidated stockholders' equity by approximately \$29.6 million. In our view, these hypothetical losses resulting from these assumed changes in foreign currency exchange rates are not material to our consolidated financial position, results of operations or cash flows.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (Disclosure Controls), as defined by Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 as of the end of the period covered by this Quarterly Report on Form 10-Q. The Disclosure Controls evaluation was done under the supervision and with the participation of management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based upon this evaluation, our CEO and CFO have concluded that our Disclosure Controls were effective at the reasonable assurance level as of July 2, 2011.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the Second Quarter that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

On August 5, 2011, the Company settled the three shareholder derivative lawsuits that were filed in the United States District Court for the Northern District of Texas, Dallas Division, naming the Company as a nominal defendant and naming all of the Company's then current directors and certain of its current and former officers and directors as defendants. The lawsuits alleged purported violations of federal securities laws and state law claims for breach of fiduciary duty, abuse of control, constructive fraud, corporate waste, unjust enrichment and gross mismanagement in connection with certain stock option grants made by the Company. The settlement provided in part for the following: (i) payment to the Company of approximately \$8.7 million by the insurance carriers for the individual defendants; (ii) the adoption or maintenance by the Company of certain corporate governance measures; and (iii) in payment of plaintiff's counsel's fees and expenses (a) the issuance by the Company to plaintiff's counsel of approximately \$7.8 million in shares of the Company's common stock and (b) the granting to plaintiff's counsel of a stock option to acquire up to 32,000 shares of the Company's common stock. The settlement did not have a material impact on the condensed consolidated financial statements.

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There are no other legal proceedings to which we are a party or to which our properties are subject, other than routine litigation incident to our business, which is not material to our consolidated financial condition, results of operations or cash flows.

Item 1A. Risk Factors

There were no material changes to the risk factors set forth in the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2011 and the Company's Form 10-Q for the quarter ended April 2, 2011.

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

The following table sets forth the repurchases of shares of our common stock during the fiscal quarter ended July 2, 2011:

ISSUER PURCHASES OF EQUITY SECURITIES (1) (2)

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans |
|--------------------------------|---|---|---|---|
| April 3, 2011 - April 30, 2011 | 338,789 | \$ 93.68 | 338,789 | \$ 474,519,995 |
| May 1, 2011 - May 28, 2011 | 69,440 | \$ 97.18 | 69,440 | \$ 467,771,530 |
| May 29, 2011 - July 2, 2011 | 207,951 | \$ 107.45 | 207,951 | \$ 445,427,243 |
| Total | 616,180 | | 616,180 | |

ISSUER PURCHASES OF EQUITY SECURITIES (1) (2)

- (1) The table includes purchases made during our fiscal first quarter of 2011 and settled in the Second Quarter. The settlement date is generally three trading days following the trade date.
- (2) On August 10, 2010, we announced a common stock repurchase program pursuant to which up to \$30 million could be used to repurchase outstanding shares of our common stock. On August 30, 2010, we announced a common stock repurchase program pursuant to which up to \$750 million could be used to repurchase outstanding shares of our common stock. The \$750 million repurchase program has a termination date in December 2013 and the \$30 million repurchase program has no termination date.

Item 6. Exhibits

(a) Exhibits

- 3.1 Third Amended and Restated Certificate of Incorporation of Fossil, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed on May 25, 2010).
- 3.2 Third Amended and Restated Bylaws of Fossil, Inc. (incorporated by reference to Exhibit 3.2 of the Company's Current Report on Form 8-K filed on May 25, 2010).
- 31.1(1) Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
- 31.2(1) Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
- 32.1(1) Certification of Chief Executive Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2(1) Certification of Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101(2) The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended July 2, 2011, formatted in XBRL (eXtensible Business Reporting Language), (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income and Comprehensive Income, (iii) Consolidated Statements of Cash Flows, and (iv) the Notes to the Consolidated Financial Statements.

- (1) Filed herewith.

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- (2) Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURES

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

FOSSIL, INC.

August 11, 2011

/s/ MIKE L. KOVAR

Mike L. Kovar

Executive Vice President, Chief Financial Officer and Treasurer

(Principal financial and accounting officer duly

authorized to sign on behalf of Registrant)

EXHIBIT INDEX

| Exhibit | |
|----------------|--|
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