Form

Unknown document format

left:2px;padding-top:2px;padding-bottom:2px;padding-right:2px;">

(2.8
)%

(6.6
)%

Americas Net Sales. For the Year To Date Period, Americas net sales decreased $38.0 million or 6.7% (7.1% in constant currency), compared to the Prior Year YTD Period. During the Year To Date Period, watches decreased $21.5 million or 4.9% (5.2% in constant currency) while our jewelry and leathers categories declined $8.9 million or 28.3% (29.3% in constant currency) and $7.2 million or 8.2% (8.6% in constant currency), respectively. During the Year To Date Period, sales increases in FOSSIL watches, driven by connected products, were more than offset by declines in most other brands and categories, including BURBERRY and ADIDAS due to the termination of these licenses. Geographically, sales declines in the U.S. and Canada were slightly offset by sales increases in Mexico. Although the wholesale channel sales decreased during the Year To Date Period, the direct channel performance was relatively flat as growth in our e-commerce business offset the negative impact of store closures. Comparable retail sales increased moderately in the region, with increases in our e-commerce business and in our retail stores.

The following table sets forth product net sales for the Americas segment on a reported and constant currency basis (dollars in millions):

	For the 26 Weeks Ended June 30, 2018	For the 26 Weeks Ended July 1, 2017	Growth (Decline)		
	Net Sales	Net Sales	Dollars	Percentage As Reported	Percentage Constant Currency
Watches	$ 417.3	$ 438.8	$(21.5)	(4.9)%	(5.2)%
Leathers	81.1	88.3	(7.2)	(8.2)	(8.6)
Jewelry	22.5	31.4	(8.9)	(28.3)	(29.3)
Other	7.4	7.8	(0.4)	(5.1)	(3.8)
Total	$ 528.3	$ 566.3	$(38.0)	(6.7)%	(7.1)%

Europe Net Sales. For the Year To Date Period, Europe net sales decreased $12.2 million or 3.1% (11.8% in constant currency), compared to the Prior Year YTD Period. Our jewelry category declined $7.4 million or 13.0% (21.2% in constant currency). Watches declined $3.7 million or 1.3% (9.8% in constant currency), and our leathers categories increased $0.1

million or 0.3% (decreased 10.0% in constant currency). During the Year To Date Period, most of the brands in the portfolio declined, driven by decreases in traditional watches that were partially offset by increases in connected watches. Sales were down in most major markets, including France, Germany and the United Kingdom. Comparable retail sales were moderately negative during the Year To Date Period, with growth in e-commerce sales more than offset by declines in store sales.

The following table sets forth product net sales for the Europe segment on a reported and constant currency basis (dollars in millions):

	For the 26 Weeks Ended June 30, 2018	For the 26 Weeks Ended July 1, 2017	Growth (Decline)		
	Net Sales	Net Sales	Dollars	Percentage As Reported	Percentage Constant Currency
Watches	$ 287.6	$ 291.3	$(3.7)	(1.3)%	(9.8)%
Leathers	31.0	30.9	0.1	0.3	(10.0)
Jewelry	49.7	57.1	(7.4)	(13.0)	(21.2)
Other	9.9	11.1	(1.2)	(10.8)	(18.9)
Total	$ 378.2	$ 390.4	$(12.2)	(3.1)%	(11.8)%

Asia Net Sales. For the Year To Date Period, Asia net sales increased $17.3 million or 7.8% (4.0% in constant currency), compared to the Prior Year YTD Period. Watch sales increased $16.6 million or 8.8% (5.0% in constant currency). Leathers increased $2.0 million or 8.7% (3.9% in constant currency), while jewelry declined $0.9 million or 24.3% (29.7% in constant currency). We continued to have strong sales growth in India and China, primarily driven by e-commerce. Hong Kong, Malaysia and South Korea also had positive sales growth, while Japan and our distributor markets declined. For the Year To Date Period, comparable retail sales in the region increased modestly with strong comparable sales in the e-commerce channel and moderate increases in our Fossil full-priced accessory stores, largely offset by declines in our other store concepts.

The following table sets forth product net sales for the Asia segment on a reported and constant currency basis (dollars in millions):

	For the 26 Weeks Ended June 30, 2018	For the 26 Weeks Ended July 1, 2017	Growth (Decline)		
	Net Sales	Net Sales	Dollars	Percentage As Reported	Percentage Constant Currency
Watches	$ 205.7	$ 189.1	$16.6	8.8 %	5.0 %
Leathers	25.1	23.1	2.0	8.7	3.9
Jewelry	2.8	3.7	(0.9)	(24.3)	(29.7)
Other	5.6	6.0	(0.4)	(6.7)	(8.3)
Total	$ 239.2	$ 221.9	$17.3	7.8 %	4.0 %

Gross Profit. For the Year To Date Period, gross profit margin increased 200 basis points to 52.1% compared to 50.1% in the Prior Year YTD Period. The increased gross profit margin was primarily driven by the same factors impacting the Second Quarter, including a favorable currency impact of approximately 180 basis points in the Year To Date Period.

Operating Expenses. For the Year To Date Period, total operating expenses decreased to $624.0 million compared to $1.1 billion in the Prior Year YTD Period, primarily due to intangible impairment charges recorded in the Prior Year

YTD Period. SG&A expenses were lower compared to the Prior Year YTD Period due to lower infrastructure and store costs driven by NWF. During the Year To Date Period, we incurred restructuring costs of $35.9 million under our NWF initiative compared with restructuring costs of $36.0 million in the Prior Year YTD Period. The translation of foreign-denominated expenses during the Year To Date Period increased operating expenses by approximately $22.1 million as a result of the weaker U.S. dollar. As a percentage of net sales, SG&A expenses decreased to 50.8% in the Year To Date Period as compared to 52.8% in the Prior Year YTD Period.

Consolidated Operating Income (Loss). Operating income (loss) improved to a loss of $27.3 million in the Year To Date Period as compared to a loss of $475.0 million in the Prior Year YTD Period, primarily driven by non-cash intangible impairment charges of $407.1 million incurred in the Prior Year YTD Period. SG&A expenses also decreased due to corporate and regional infrastructure reductions and lower store costs due to store closures. The increase in gross margin rate more than offset the decrease in net sales. As a percentage of net sales, operating margin was (2.4)% in the Year To Date Period as compared to (40.3)% in the Prior Year YTD Period and was positively impacted by approximately 200 basis points due to changes in foreign currencies.
Operating income (loss) by segment is summarized as follows (dollars in millions):

	For the 26 Weeks Ended June 30, 2018	For the 26 Weeks Ended July 1, 2017	Change		Operating Margin %	
			Dollars	Percentage	2018	2017
Americas	$67.2	$(140.8)	$208.0	(147.7)%	12.7 %	(24.9)%
Europe	42.4	(73.2)	115.6	(157.9)	11.2	(18.7)
Asia	33.9	(24.7)	58.6	(237.2)	14.2	(11.1)
Corporate	(170.8)	(236.3)	65.5	(27.7)		
Total operating income (loss)	$(27.3)	$(475.0)	$447.7	(94.3)%	(2.4)%	(40.3)%

Interest Expense. Interest expense increased by $1.7 million during the Year To Date Period as a result of higher interest rates on our amended credit facility, partially offset by the favorable impact of a smaller borrowing base.
Other Income (Expense)-Net. During the Year To Date Period, other income (expense)-net decreased by $10.1 million to a net expense of $2.4 million in comparison to the Prior Year YTD Period. This change was primarily driven by net foreign currency losses in the Year To Date Period compared to net gains in the Prior Year YTD Period.
Provision for Income Taxes. Income tax expense for the Year To Date Period was $3.3 million, resulting in an effective income tax rate of (6.4)%. For the Prior Year YTD Period, income tax benefit was $97.5 million, resulting in an effective income tax rate of 20.0%. The tax expense in the Year To Date Period was favorably impacted by net discrete items related to changes in the estimate of 2017 tax expense, including an increase of $2.5 million in the estimate of the one-time repatriation tax under the Tax Cuts and Jobs Act which was more than offset by a $9.7 million reduction in tax expense due to a change in method of accounting to apply the lower of cost or market method to value inventory. The Company made reasonable estimates and recorded provisional amounts in its financial statements for fiscal year 2017 as permitted under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act and expects to make additional changes to the estimate during the year as it refines the calculations and implements future expected guidance and regulations from the U.S. Department of Treasury and the Internal Revenue Service. The Prior YTD Period was negatively impacted by the inability to claim a tax deduction for certain amounts of goodwill impairment expense recorded during that period.
Additionally, income taxes are provided for under the asset and liability method for temporary differences in the recognition of assets and liabilities recognized for income tax and GAAP purposes. Deferred tax assets are periodically assessed for the likelihood of whether they are more likely than not to be realized. We have previously established a valuation allowance in those jurisdictions where we believe recovery is not more likely than not, which generally increases tax expense in the period such determination is made. For those jurisdictions with deferred tax assets not currently subject to a valuation allowance, including the U.S., we have determined that the realization of deferred tax assets continues to be more likely than not.
Net Income (Loss) Attributable to Fossil Group, Inc. Year To Date Period net income (loss) attributable to Fossil Group, Inc. improved to a loss $56.1 million, or $1.15 per diluted share, in comparison to a loss of $392.9 million, or $8.12 per diluted share, in the Prior Year YTD Period, primarily due to a $6.51 per diluted share impact of intangible impairment charges recorded during the Prior Year YTD Period. Diluted earnings (loss) per share was negatively impacted by restructuring charges of $0.58 in the Year To Date Period and $0.48 in the Prior Year YTD Period.

Diluted earnings per share in the Year To Date Period, as compared to the Prior Year YTD Period, increased $0.18 due to the currency impact of a weaker U.S. dollar.

Liquidity and Capital Resources
Our cash and cash equivalents balance at the end of the Second Quarter was $241.8 million, including $210.6 million held in banks outside the U.S., in comparison to cash and cash equivalents of $319.8 million at the end of the Prior Year Quarter and $231.2 million at the end of fiscal year 2017. Historically, our business operations have not required substantial cash during the first several months of our fiscal year. Generally, starting in the third 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 strategic investments such as acquisitions, other capital expenditures and restructuring charges. We believe cash from operating activities as well as amounts available under our credit facilities are sufficient to meet our cash needs for the next 12 months.
For the Year To Date Period, we generated operating cash flow of $77.4 million. Net loss of $54.7 million was offset by net non-cash items of $36.4 million and a decrease in working capital items of $95.6 million. We had net debt payments of $45.0 million and capital expenditures of $6.3 million.
Accounts receivable, net of allowances, decreased by 14.9% to $204.7 million at the end of the Second Quarter compared to $240.4 million at the end of the Prior Year Quarter. Days sales outstanding for our wholesale businesses for the Second Quarter decreased to 44 days compared to 50 days in the Prior Year Quarter as a result of increased collections primarily in the Americas department store channel.
Accounts payable at the end of the Second Quarter was $139.5 million, which decreased by 14.7% from the end of the Prior Year Quarter ending accounts payable balance of $163.5 million. The decrease in accounts payable was largely due to reductions in inventory purchases.
Inventory at the end of the Second Quarter was $497.8 million, which decreased by 19.5% from the end of the Prior Year Quarter ending inventory balance of $618.1 million, as we are making progress on our inventory reduction efforts and have significantly reduced our inventories of traditional watches. We remain focused on clearing previous generation connected products over the next few fiscal quarters.
At the end of the Second Quarter, we had net working capital of $561.8 million compared to net working capital of $890.7 million at the end of the Prior Year Quarter. At the end of the Second Quarter, we had approximately $127.7 million of short-term borrowings and $268.4 million in long-term debt.
For fiscal year 2018, we expect total capital expenditures to be approximately $25 million. Of this amount, we expect approximately 35% will be for technology and facilities maintenance, approximately 35% will be for strategic growth, including investments in omni-channel, global concessions and technology, and approximately 30% will be for retail store renovations and enhancements. Our capital expenditure budget and allocation to the foregoing investments are estimates and are subject to change. We believe that cash flows from operations combined with existing cash on hand and amounts available under our credit facilities will be sufficient to fund our working capital needs and planned capital expenditures for the next twelve months.

On January 29, 2018, we and certain of our foreign subsidiaries, as non-U.S. borrowers, entered into a Second Amended and Restated Credit Agreement (the "Credit Agreement"). The Credit Agreement provides for (i) revolving credit loans in the amount of $325 million, subject to a borrowing base (as described below) (the "Revolving Credit Facility"), with an up to $45.0 million subfacility for letters of credit, and (ii) a term loan in the amount of $425 million (the "Term Loan Facility"). The Credit Agreement expires and is due and payable on December 31, 2020.

Availability under the Revolving Credit Facility and any letters of credit are subject to a borrowing base equal to, (a) with respect to Fossil Group Inc., the sum of (i) 85% of eligible U.S. accounts receivable and 90% of net U.S. credit card receivables (less any dilution reserve), (ii) the lesser of (A) 65% of the lower of cost or market value of eligible U.S. finished good inventory and (B) 85% of the appraised net orderly liquidation value of eligible U.S. finished good inventory, and (iii) until the earlier of (x) March 31, 2018 and (y) the date on which certain of our foreign subsidiaries join the Credit Agreement as non-U.S. borrowers, (A) 35% of eligible foreign accounts receivable of certain pledged foreign subsidiaries, plus (B) the least of (x) 35% of the lower of cost or market value of eligible foreign finished good inventory of such pledged foreign subsidiaries, (y) 35% of the appraised net orderly liquidation value of eligible

foreign finished good inventory of such pledged foreign subsidiaries, and (z) $100,000,000, minus (C) all indebtedness for borrowed money of such pledged foreign subsidiaries (subject to exceptions) minus (iv) the aggregate amount of reserves, if any, established by the Administrative Agent in good faith and in the exercise of reasonable business judgment from the perspective of a secured asset-based lender; and (b) with respect to each non-U.S. borrower, the sum of (i) 85% of eligible accounts receivable of the non-U.S. borrowers (less any

dilution reserve) and (ii) the least of (A) 65% of the lower of cost or market value of eligible foreign finished goods inventory of the non-U.S. borrowers, (B) 85% of the appraised net orderly liquidation value of eligible foreign finished goods inventory of the non-U.S. borrowers, and (C) $185,000,000 minus (iii) the aggregate amount of reserves, if any, established by the Administrative Agent in good faith and in the exercise of reasonable business judgment from the perspective of a secured asset-based lender.

In connection with the Credit Agreement, we and all of our domestic subsidiaries entered into a Collateral Agreement in favor of the Administrative Agent, pursuant to which we and our subsidiaries granted liens on all or substantially all of our assets in order to secure our obligations under the Credit Agreement and the other loan documents (the “Obligations”). Additionally, all of our domestic subsidiaries entered into a Guaranty Agreement in favor of the Administrative Agent, pursuant to which such subsidiaries guarantee the payment and performance of the Obligations. Additionally, Fossil Group Europe and the other non-U.S. borrowers from time to time party to the Credit Agreement are required to enter into security instruments with respect to all or substantially all of their assets that can be pledged under applicable local law.

The Credit Agreement amended and restated that certain credit agreement, dated as of March 9, 2015, as amended, which was scheduled to mature on May 17, 2019 (the "Prior Agreement"). As of January 29, 2018, we had $497.0 million in aggregate principal amount of revolving credit loans and no term loans outstanding under the Prior Agreement, all of which was refinanced on January 29, 2018 with borrowings under the Credit Agreement. No penalties or other early termination fees were incurred in connection with the amendment and restatement of the Prior Agreement. We recorded a loss of $0.7 million in other income (expense) - net during the first quarter of fiscal year 2018 for debt issuance costs associated with the Prior Agreement.

Amounts outstanding under the Revolving Credit Facility bear interest per annum at the (a) LIBOR rate plus the applicable interest margin, (b) the daily LIBOR rate plus the applicable interest margin or (c) the base rate plus the applicable interest margin. The applicable interest margin varies from 4.00% to 5.00% for LIBOR rate loans and daily LIBOR rate loans and 1.50% to 3.00% for base rate loans and is based on our average daily excess availability under the Revolving Credit Facility for the most recently ended calendar quarter, which is an amount equal (a) the lesser of (i) $325 million and (ii) the aggregate borrowing base minus (b) the amount of all outstanding borrowings and letter of credit obligations under the Revolving Credit Facility, for each day during the applicable period divided by the number of days in such period. The applicable interest margin will increase by 1% per annum on each anniversary of the closing of the Credit Agreement.

Amounts outstanding under the Term Loan Facility bear interest at a rate per annum equal to (a) the LIBOR rate plus 7%, increasing to the LIBOR rate plus 8% on the first anniversary of the closing of the Credit Agreement and the LIBOR rate plus 9% on the second anniversary of the closing of the Credit Agreement and thereafter or (b) the base rate plus 5.5%, increasing to the base rate plus 6.5% on the first anniversary of the closing of the Credit Agreement and to the base rate plus 7.5% on the second anniversary of the closing of the Credit Agreement and thereafter.

We are required to repay the outstanding principal balance of the Term Loan Facility in the amount of $125 million on March 31, 2019, $75 million on March 31, 2020 and the outstanding balance on December 31, 2020. Additionally, loans under the Credit Agreement may be prepaid, in whole or in part, at our option, in minimum principal amounts of (a) $1.0 million or increments of $1.0 million in excess thereof, with respect to a base rate loan under the Revolving Credit Facility, (b) $5.0 million or increments of $1.0 million in excess thereof, with respect to a LIBOR rate loan or a daily LIBOR rate loan under the Revolving Credit Facility, and (c) $5.0 million or increments of $1.0 million in excess thereof, with respect to the Term Loan Facility. Loans under the Credit Agreement must be repaid with the net cash proceeds of certain asset sales, insurance and condemnation events, certain debt and equity issuances and certain cash dividends received from our subsidiaries. We may permanently reduce the revolving credit commitment at any time, in whole or in part, without premium or penalty, in a minimum aggregate principal amount of not less than $3.0

million or increments of $1.0 million in excess thereof.

We are required to pay a commitment fee on the unused amounts of the commitments under the Revolving Credit Facility, payable quarterly in arrears, of 0.5% on the average daily unused portion of the overall commitment under the Revolving Credit Facility.

The repayment obligation under the Credit Agreement can be accelerated upon the occurrence of an event of default, including the failure to pay principal or interest, a material inaccuracy of a representation or warranty, violation of covenants, cross-default, change in control, bankruptcy events, failure of a loan document provision, certain ERISA events and material judgments.

Financial covenants governing the Credit Agreement require us to maintain (a) a minimum fixed charge coverage ratio measured quarterly on a rolling twelve-month basis of 1.15 to 1.00 if the Company’s quarter-end balances of cash and cash

equivalents plus the excess availability under the Revolving Credit Facility is less than $200 million; (b) a maximum leverage ratio measured as of the last day of each fiscal quarter for the period of four fiscal quarters ending on such date of (i) 4.5 to 1.0 for the period ending March 31, 2018, (ii) 4.75 to 1.0 for the period ending June 30, 2018, (iii) 5.0 to 1.0 for the period ending September 29, 2018, (iv) 4.25 to 1.0 for the period ending December 29, 2018, (v) 3.75 to 1.0 for each fiscal quarter ending during the period from December 30, 2018 through September 28, 2019, and (vi) 3.5 to 1.0 thereafter; (c) a minimum trailing twelve-month EBITDA tested quarterly of $110 million (beginning with the fiscal quarter ending December 29, 2018); (d) a minimum liquidity covenant of unrestricted cash and cash equivalents plus available and unused capacity under the Revolving Credit Facility equal to $160 million; and (e) maximum capital expenditures of $35 million per year. Additionally, we are restricted from making open market repurchases of its common stock.

During the Year To Date Period, we had net borrowings of $400.0 million under the Term Loan at an average annual interest rate of 8.8%. Additionally, we had net payments of $445.0 million under the Revolving Credit Facility and revolving credit loans under the Prior Agreement during the Year To Date Period at an average annual interest rate of 5.4%. As of June 30, 2018, we had $400.0 million outstanding under the Term Loan and no loans outstanding under the Revolving Credit Facility. We also had unamortized debt issuance costs of $9.4 million, which reduce the corresponding debt liability. In addition, we had $2.7 million of outstanding standby letters of credit at June 30, 2018. Amounts available under the Revolving Credit Facility are reduced by any amounts outstanding under standby letters of credit. As of June 30, 2018, we had available borrowing capacity of $245.3 million under the Revolving Credit Facility. Borrowings under the Revolving Credit Facility were mainly used to fund normal operating expenses and capital expenditures. At June 30, 2018, we were in compliance with all debt covenants related to all our credit facilities.

Off Balance Sheet Arrangements

As of June 30, 2018, there were no material changes to our off balance sheet arrangements as set forth in commitments and contingencies in our Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with GAAP 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 condensed consolidated financial statements and the reported amounts of revenues and expenses during the periods reported. 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.

In May 2014, the Financial Accounting Standards Board issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”) and subsequently issued guidance that amended ASU 2014-09. We adopted ASU 2014-09 in January 2018 using the modified retrospective approach. As a result of the new guidance, we began estimating markdowns given to customers at the time of sale using historical data. Markdowns are recorded as a reduction of revenue and accounts receivable. Prior to the adoption of ASU 2014-09, markdowns were recorded when agreed upon with the customer.

Other than noted above and in "Note 1—Financial Statement Policies" and "Note 2—Revenue" to the condensed consolidated financial statements, 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 December 30, 2017.

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 expressio 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; interruptions or delays in the supply of key components; 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, including risks related to the expanded launch of connected accessories; 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; risks related to the success of NWF; 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 December 30, 2017. 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

Foreign Currency Exchange Rate Risk

As a multinational enterprise, we are exposed to changes in foreign currency exchange rates. Our most significant foreign currency risk relates to the euro and, to a lesser extent, the Canadian dollar, British pound, Japanese yen, Mexican peso and Australian dollar as compared to the U.S. dollar. Due to our vertical nature whereby a significant portion of goods are sourced from our owned entities, we face foreign currency risks related 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 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. Additionally, we enter into forward contracts to manage fluctuations in Japanese yen exchange rates that will be used to settle future third-party inventory component purchases by a U.S. dollar functional currency subsidiary. The use of 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 management does not anticipate any significant changes in such exposures or in the strategies we employ to manage such exposure in the near future.

The following table shows our outstanding forward contracts designated as cash flow hedges for inventory transactions (in millions) at June 30, 2018 and their expiration dates.

Functional Currency		Contract Currency		
Type	Amount	Type	Amount	Expiring Through
Euro	165.2	U.S. dollar	196.6	November 2019
Canadian dollar	61.4	U.S. dollar	47.9	December 2019
British pound	26.5	U.S. dollar	35.2	December 2019
Japanese yen	2,556.1	U.S. dollar	23.6	December 2019
Mexican peso	173.2	U.S. dollar	8.6	November 2018
Australian dollar	6.9	U.S. dollar	5.3	December 2018
U.S. dollar	18.1	Japanese yen	1,960.0	May 2019

If we were to settle our euro, Canadian dollar, British pound, Japanese yen, Mexican peso, Australian dollar and U.S. dollar based forward contracts hedging inventory transactions as of June 30, 2018, the net result would have been a net gain of approximately $5.0 million, net of taxes. As of June 30, 2018, 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 $19.0 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. As of June 30, 2018, 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 $48.3 million.

Interest Rate Risk

We are subject to interest rate volatility with regard to debt borrowings. Based on our variable-rate debt outstanding as of June 30, 2018, a 100 basis point increase in interest rates would increase annual interest expense by approximately $4.1 million.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We conducted an evaluation of the effectiveness 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 amended (the “Exchange Act”), 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 as of June 30, 2018.

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

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

Item 1A. Risk Factors

You should carefully consider the following risk factor in addition to other information included in this Quarterly Report on Form 10-Q, in our Annual Report on Form 10-K for the year ended December 30, 2017 and in other documents we file with the SEC, in evaluating the Company and its business.

If significant tariffs or other restrictions are placed on imports from China or any retaliatory trade measures are taken by China, our revenue and results of operations may be materially harmed.

If significant tariffs or other restrictions are placed on imports from China or any retaliatory trade measures are taken by China, our revenue and results of operations may be materially harmed. In July 2018, the Trump Administration announced a list of thousands of categories of goods, including electronics, that could face tariffs of 10% to 25%. It is expected that these tariffs will be finalized after a public comment period ending in early September 2018. If the tariff list remains unaltered, a portion of our products, including smart watches that are assembled and manufactured in China, would be subject to a 10% to 25% tariff assessed on the first cost price of these products as imported into the United States. If these duties are imposed on our products, we may be required to raise our prices, which may result in the loss of customers and harm our operating performance. Alternatively, we may seek to shift production outside of China, resulting in significant costs and disruption to our operations. Additionally, the Trump Administration continues to signal that it may alter trade agreements and terms between China and the United States, including limiting trade with China, and may impose additional tariffs on imports from China and potentially impose other restrictions on exports from China to the United States. Even if the currently proposed duties are not imposed on our products, it is possible further tariffs will be imposed on imports of our products, or that our business will be impacted by retaliatory trade measures taken by China or other countries in response to existing or future tariffs, causing us to raise prices or make changes to our operations, any of which could materially harm our revenue or operating results.

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

There were no shares of common stock repurchased under any of our repurchase programs during the Second Quarter. We are currently prohibited by the terms of our Revolving Credit Facility from repurchasing shares of our common stock.

Item 5. Other Information

We mutually agreed with Karl Lagerfeld B.V. to terminate, effective April 1, 2018, the watch license between the parties, subject to a sell-off period.

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Document Description
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	Certificate of Amendment of the Third Amended and Restated Certificate of Incorporation of Fossil, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on May 28, 2013).
3.3	Fifth Amended and Restated Bylaws of Fossil Group, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K filed on April 3, 2017).
10.1(1)(3)	First Amendment to the Fossil Group, Inc. 2016 Long-Term Incentive Plan.
10.2(1)(3)	Waiver of Portion of 2018 Automatic Grant
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(2)	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(2)	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.INS(1)	XBRL Instance Document.
101.SCH(1)	XBRL Taxonomy Extension Schema Document.
101.DEF(1)	XBRL Taxonomy Extension Definition Linkbase Document.
101.CAL(1)	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB(1)	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE(1)	XBRL Taxonomy Extension Presentation Linkbase Document.

---

(1) Filed herewith.
(2) Furnished herewith.
(3) Management contract or compensatory plan or arrangement.

46

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 GROUP, INC.

August 9, 2018	/S/ JEFFREY N. BOYER
	Jeffrey N. Boyer Executive Vice President, Chief Financial Officer and Treasurer (Principal financial and accounting officer duly authorized to sign on behalf of the Registrant)

47