

FOSSIL INC
Form 10-K
March 05, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the Fiscal Year Ended January 5, 2008

OR

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

For the transition period from to

Commission File Number **0-19848**

FOSSIL, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

75-2018505

(I.R.S. Employer Identification No.)

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2280 N. Greenville Avenue
Richardson, Texas
(Address of principal executive offices)

75082
(Zip Code)

Registrant's telephone number, including area code: **(972) 234-2525**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, \$.01 par value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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

Smaller reporting company

(Do not check if a smaller reporting company)

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

The aggregate market value of Common Stock, \$0.01 par value per share (the Common Stock), held by nonaffiliates of the registrant, based on the sale trade price of the Common Stock as reported by the NASDAQ Global Select Market on July 8, 2007, was \$1,335,760,495. For purposes of this computation, all officers, directors and 10% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed an admission that such officers, directors or 10% beneficial owners are, in fact, affiliates of the registrant.

As of February 25, 2008, 68,855,671 shares of Common Stock were outstanding.

FOSSIL, INC.

FORM 10-K

FOR THE FISCAL YEAR ENDED JANUARY 5, 2008

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In this Form 10-K, references to we, our, and the Company refer to Fossil, Inc. and its subsidiaries on a consolidated basis.

PART I

Item 1. Business

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 sold under proprietary and licensed brands, handbags, small leather goods, belts, sunglasses, and apparel. In the watch and jewelry product category, we have 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, export and direct to the consumer 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, owned and affiliate internet sites and through our FOSSIL® catalog. Our broadly based wholesale customer base includes retailers such as Neiman Marcus, Nordstrom, 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, which included 96 retail stores located in premier retail sites and 74 outlet stores located in major outlet malls as of January 5, 2008. In addition, we offer an extensive collection of our FOSSIL brand products through our catalog and at our web site, www.fossil.com as well as proprietary and licensed watch and jewelry brands through other managed and affiliate websites.

Internationally, our products are sold to department stores, specialty retail stores, and specialty watch and jewelry stores in over 90 countries worldwide through 23 company-owned foreign sales subsidiaries and through a network of approximately 56 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 55 accessory retail stores, 13 multi-brand stores and 6 outlet stores in select international markets as of January 5, 2008. Additionally, our products are sold through independently-owned FOSSIL retail stores and kiosks in certain international markets.

We are a Delaware corporation formed in 1991 and are the successor to a Texas corporation formed in 1984. In 1993, we completed an initial public offering of 13,972,500 shares of our common stock, as adjusted for four three-for-two stock splits to date. Domestically, we conduct a majority of our operations through Fossil Partners, L.P., a Texas limited partnership formed in 1994 of which we are the sole general partner. We also conduct operations domestically and in certain international markets through various owned subsidiaries. Our principal executive offices are located at 2280 N. Greenville Avenue, Richardson, Texas 75082, and our telephone number at such address is (972) 234-2525. Our European headquarters is located in Basel, Switzerland. Our common stock is traded on the NASDAQ Global Select Marketplace under the trading symbol FOSL. We make available free of charge through our website at www.fossil.com our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports. You may also obtain any materials we file with, or furnish to, the SEC on its website at www.sec.gov.

Business Segments

Our operations and financial reporting are primarily divided into four distinct segments that include the United States wholesale segment, the Europe wholesale segment, the other International wholesale segment and our direct to consumer segment, which includes our company-owned retail stores, our catalog and e-commerce activities. Within the wholesale segments of our business we generally sell to retailers in those countries in which we have a physical presence as well as to distributors in countries where we do not have a physical presence. Except to the extent that differences between operating segments are material to an

understanding of our business taken as a whole, the description of our business in this report is presented on a consolidated basis. For financial information about our operating segments and geographic areas, refer to Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Part II, Item 7 and Note 13 Major Customer, Segment and Geographical Information to our Consolidated Financial Statements set forth in Part II, Item 8 of this Annual Report on Form 10-K.

Business Strengths

We believe that we have several business strengths which allow us to differentiate ourselves and execute our key operating and financial goals. These business strengths include:

Brand Strength. We believe a brand's image, individuality, consistency and connection with its customers is paramount in building and sustaining the brand. We believe that our FOSSIL brand name is recognized on a global basis for vintage-inspired products for the aspirational individual. The FOSSIL brand has scaled from its origin as a watch brand to encompass numerous other accessory categories, including handbags, belts, small leather goods, jewelry and sunglasses to a beginning emergence in apparel. We believe the FOSSIL brand is one of our most valuable assets, serves as a foundational piece of our business and remains very scalable across product lines, geographic areas and distribution channels. Since our inception in 1984, we have continued to develop, acquire or license other nationally or internationally recognized brand names in order to appeal to a wide range of consumers, including ADIDAS®, BURBERRY®, DIESEL®, DKNY®, EMPORIO ARMANI®, MARC BY MARC JACOBS, MICHELE®, MICHAEL Michael Kors®, RELIC® and ZODIAC®. Our industry is highly competitive and subject to changing preferences in style, taste and price points. The success of our business model depends upon offering a wide range of branded products that appeal to the various tastes and fashion preferences of our customers. We must also maintain the relevance of these products by continually anticipating customer needs and desires as they relate to both the brands and categories of product we offer. We have teams of designers and product specialists assigned to each of the brands we offer. The objectives of these designers and brand specialists are to immerse themselves in their assigned brand and product area, identify their customers' preferences, interpret global fashion trends and develop style-right offerings to generate volume purchasing. By owning the vast majority of our global distribution we are also able to create and execute both consistent pricing strategies and brand image presentations that protect and enhance our proprietary brands and those of our licensors.

Licensing Strength. Since 1997, we have attracted highly recognized and respected brand names to license within our watch portfolio. We believe we attract such quality brands due to our ability to provide them with access to our global design, production, distribution and marketing infrastructure. As a result of our vertical integration we, unlike many of our competitors, can offer an integrated solution to launch or increase their accessory category presence on a worldwide basis in a consistent, timely and focused manner. Our licensing relationships are exclusive to us and the licensors, which substantially removes certain risks to the licensor associated with dealing with multiple licensees in different geographic regions. Additionally, in order to develop a broader relationship and maintain brand consistency across the accessory categories, we have also broadened our infrastructure allowing us to expand our licensing activities to products beyond the watch category, as evidenced by our EMPORIO ARMANI and DIESEL jewelry product lines.

Breadth of Brands & Price Points. Through the multiple brands we distribute we have developed a broad spectrum of retail price points. Within our watch collections, retail price points vary from approximately \$6 for brands sold in the mass market channel up to retail price points of \$3,000 in the luxury distribution channel. The breadth of our brands allows us to anchor a brand to a given price point range and distribution channel, thereby maintaining a consistent brand image while focusing on the quality/value relationship important to the customer and not diluting the brand through overlapping distribution channels. The breadth of price points allows us to cater to various age and income groups while continuing to participate in sales consistently, regardless of a shift in income or the price/value preferences of our customers.

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International Penetration. Since our initial public offering in 1993, we have continued to extend our reach beyond the United States by forming and acquiring internationally-based subsidiaries, licensing and developing internationally recognized brands and investing in the growth of our business within the major countries of the world. For fiscal year 2007, 61% of our wholesale net sales and 54% of our total net sales were generated outside of the United States.

Breadth of Distribution Channels. Our products are sold through multiple distribution channels including department stores, specialty retail stores, specialty watch and jewelry stores, mass market stores, sport stores, cruise ships, airlines, owned-retail, business to business, the internet and our catalog. As we continue to expand our presence in existing distribution channels and add new distribution channels, as well as develop new product lines and expand our geographic reach, our revenues become less dependent on any one product, brand, distribution channel or geographic region. Our owned-retail, internet and catalog venues allow us to enhance the related brand image by offering a targeted message to the customer, showcasing the array of product availability, influencing the merchandising and presentation of the products and testing new product introductions.

In-house Creative Team. Since our inception, we have developed a talented pool of creative individuals who design our products, packaging, graphics, presentation displays and marketing materials, allowing us to deliver a unique and cohesive style and image for each of our brands. We believe our emphasis on constant innovation and distinctive design has made us a leader in the branded accessory category. The breadth of talent and vertical integration of our design teams allows us to minimize the need for outside creative talent and advertising agencies which results in savings to the Company.

International Sourcing. The vast majority of our products are sourced internationally. Most watch product sourcing from Asia is coordinated through our Hong Kong subsidiary Fossil (East) Limited (Fossil East), which we acquired in 1993. During 2007, approximately 55% of our non-Swiss made watch production was assembled through wholly or majority owned factories. This vertical integration of our business allows for better flow of communication, consistent quality, product design protection and improved supply chain speed while still allowing us to utilize non-owned production facilities for their unique capabilities and to cover production needs over internal capacities. Establishing our watch assembly facilities near the component manufacturers also allows us to avoid the capital expenditures involved with manufacturing facilities and operate a more efficient supply chain. We have also been successful in leveraging our jewelry production needs through our watch assembly factory infrastructure. Our other accessory and apparel products are purchased from third party manufacturers with whom we have long-standing relationships and we typically represent a meaningful portion of their businesses.

Operating Cash Flow. The Company has historically experienced strong operating cash flows including \$132.0 million in fiscal year 2007, and \$315.0 million and \$469.8 million over the past three years and five years, respectively. This strong cash flow has allowed us to operate at low debt levels while continually funding capital expenditures, acquisitions and common stock buy back programs.

Information Systems. Operating and managing a global public company requires sophisticated and reliable management information systems to assist in the planning, order processing, production, accounting and distribution functions of each relevant business. In 2003, we implemented a SAP Enterprise Resource Planning system and are continuing to roll this system out to our larger international subsidiaries. For many of our subsidiaries which do not currently demand the complexity of the SAP solution, we have implemented Microsoft's Dynamics Navision Enterprise Resource Planning System (Navision). Additionally, we have recently upgraded our e-commerce platform to an IBM mainframe system which will allow us to leverage the success of our U.S.-based web business across many of the countries wherein we currently distribute. We also recently implemented SAP's Retail Merchandise Planning to improve our ability to manage our growing owned-retail environment globally. We believe the implementation of these systems will allow us to gain better insight into our businesses in real-time on a global basis, assist us in meeting the needs of our customers in a professional and timely manner and provide a scalable infrastructure to accommodate further growth. Our company's products are principally distributed from two primary warehouses, one located in Texas, near our headquarters, and the other located in southern Germany. Both of these facilities utilize sophisticated automated material handling equipment and software designed to improve accuracy, speed and quality in our warehousing operations.

Growth Strategy

In order to expand our global market share in a profitable manner, we continually establish and implement business initiatives that we believe will build brand equity, increase revenues and improve profitability. Our key operating and financial goals are as follows:

Extend product categories of existing brands. We continually introduce new accessory product categories within our existing proprietary and licensed brands to further leverage our branded portfolio. A recent example of this is our jewelry collections offered under the EMPORIO ARMANI, DIESEL and FOSSIL brands which were introduced after first establishing a market for the brands in watches. Additionally, during the fall of 2007, we leveraged the FOSSIL brand name with the introduction of cold weather accessories such as hats, gloves and scarves.

Introduce new brands. We continually introduce new brands through the development or acquisition of proprietary brands and licensing agreements related to recognizable global fashion brands to attract a wide range of consumers with differing tastes and lifestyles. For example, our current portfolio of proprietary and licensed watch brands allows us to compete for market share from the luxury branded market to the mass market level. In 2006, we licensed the ADIDAS brand to gain a greater market share of watches sold through sporting goods channels and to sports-minded consumers.

Expand international business. Since our initial public offering in 1993, international expansion has been a key driver in our long term growth strategy. We have continued to increase our penetration of the international market by building brand name recognition, broadening the selection of merchandise through existing distribution channels by introducing new products or brands, extending product categories under our existing portfolio of brands, purchasing former distributors to gain increased control over international businesses, establishing owned or licensed retail stores and entering new geographic markets through owned subsidiary or distributor relationships. For example, in 2005, we acquired our distributors in Taiwan and Sweden, and in 2006, we acquired the assets of our distributor in Mexico and formed a distribution subsidiary in Shanghai, China. In 2007, we also formed distribution subsidiaries in India and Korea.

Leverage infrastructure. We are building our design, marketing, assembly and distribution infrastructure to allow us to manage and grow our businesses. As we continue to develop additional products and brands and seek additional businesses and products to complement our existing product lines, we believe we will be able to leverage our infrastructure and continue to increase the efficiency of our operations.

Expand retail locations. Historically, we have expanded our company-owned retail and outlet locations. Distribution through our company-owned retail stores has allowed us to raise awareness of the FOSSIL brand and showcase a broad assortment of FOSSIL branded products in a warm and inviting atmosphere. Our FOSSIL retail stores, combined with the FOSSIL branded catalog distribution and the website, have continued to build brand equity, present a consistent brand image, influence the merchandising and presentation of our products at other retailers and allowed us to test new product categories and designs. With the level of awareness we have achieved for the FOSSIL brand worldwide and the expansion of product categories offered under the brand, we believe our FOSSIL retail store growth can now be accelerated. Of the 244 company-owned retail stores open as of January 5, 2008, 225 of these stores are FOSSIL branded stores. We plan to open 80 to 85 additional FOSSIL branded stores in 2008 depending upon available retail locations and lease terms that meet our requirements. The majority of these new store openings will be for our full price accessory concept in the U.S. and Europe, and to a lesser extent, the Asia Pacific region.

Operating strategy

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Fashion orientation and design innovation. We are able to market our products to consumers with differing tastes and lifestyles by offering a wide range of brands and product categories at a variety of price points. We attempt to stay abreast of emerging fashion and lifestyle trends affecting accessories and apparel and we respond to these trends by making adjustments in our product lines several times each year. We differentiate our products from those of our competitors principally through innovations in fashion details, including variations in the treatment of dials, crystals, cases, straps and bracelets for our watches, and innovative treatments and details in our other accessories.

Coordinated product promotion. We coordinate in-house product design, packaging, advertising, our website and catalog and in-store presentations to more effectively and cohesively communicate to our target markets the themes and images associated with our brands. For example, many of our watch products and certain of our accessory products are packaged in metal tins decorated with designs consistent with our marketing strategy and product image. In certain parts of the world, we generally market our fashion

accessory lines through the same distribution channels as our watch lines, using similar in-store presentations, graphics and packaging.

Captive suppliers. The two entities that assemble or source the majority of our Asia watch production volume are majority-owned by us. In addition, although we do not have long-term contracts with our unrelated accessory manufacturers in the Far East, we maintain long-term relationships with several manufacturers. These relationships have developed due to the number of years that we have been conducting business with and visiting the same manufacturers and because of the small amount of turnover in the employees of our manufacturers. We believe that we are able to exert significant operational control with regard to our principal watch assemblers because of our level of ownership. We believe that the relative size of our business with non-owned watch manufacturers and our accessory manufacturers gives us priority within their production schedules. Further, the manufacturers understand our quality standards, thereby allowing us to produce quality products, reduce the delivery time to market and improve overall operating margins.

Actively manage retail sales. We manage the retail sales process with our wholesale customers by monitoring consumer purchases and retail inventory levels by product category and style, primarily through electronic data interchange, and by assisting our wholesale customers in the conception, development and implementation of their marketing programs. Through our merchandising unit we work with retailers to ensure that our products are properly stocked and displayed in accordance with our visual standards. As a result, we believe we enjoy close relationships with our principal wholesale customers, often allowing us to influence the mix, quantity and timing of their purchasing decisions.

Centralized distribution. We distribute substantially all of our products sold domestically and certain of our products sold in international markets from our warehouse and distribution centers located in Texas. Internationally, we distribute our products primarily through our warehouse and distribution center located in Germany and supplement that distribution from other in-country warehouses located in other international locations. We believe our centralized distribution capabilities enable us to reduce inventory risk, increase flexibility in meeting the delivery requirements of our customers and maintain cost advantages as compared to our competitors.

Industry overview

Watch products

We believe that the current market for watches generally can be divided into four segments. One segment of the market consists of fine watches characterized by internationally known brand names such as Audemars Piguet, Cartier, Omega, Patek Philippe, Piaget and Rolex. Watches offered in this segment are usually made of precious metals or stainless steel and may be set with precious gems. These watches are almost exclusively manufactured in Switzerland and are sold by trade jewelers and in the fine jewelry departments of better department stores and other purveyors of luxury goods at retail prices ranging from \$1,500 to in excess of \$20,000. A portion of our MICHELE line competes in this market. A second segment of the market consists of fine premium branded and designer watches produced in Switzerland and the Far East such as Gucci, Movado, Raymond Weil, Seiko, Tag Heuer and Tissot. These watches are sold at retail prices generally ranging from \$150 to \$1,500. Our BURBERRY, EMPORIO ARMANI, MARC BY MARC JACOBS, MICHELE and ZODIAC lines generally compete in this market segment. A third segment of the market consists of watches sold by mass marketers, which typically consist of digital and analog watches manufactured in the Far East. Well known brands in this segment include Armitron, Casio and Timex. Retail prices in this segment range from \$5 to \$60. We compete in this segment through our Allude, Christian Benet and Trophy lines as well through the design and production of private label watch products for Wal-Mart and Target.

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The fourth segment of the market consists of moderately priced watches characterized by contemporary fashion and well known fashion brand names. Moderately priced watches are typically produced in Japan, China or Hong Kong and are sold by department stores and specialty stores at retail prices ranging from \$40 to \$150. This market segment is targeted by us with our FOSSIL and RELIC lines and by our principal competitors, including the companies that market watches under the Anne Klein II, Guess?, Kenneth Cole and Swatch brand names, whose products attempt to reflect emerging fashion trends in accessories and apparel.

Our DKNY, DIESEL, MARC BY MARC JACOBS and MICHAEL Michael Kors lines generally compete in this segment as well. With the addition of our ADIDAS line of women's, men's and children's sport timepieces in January 2006, we also compete in the sports specialty area of this segment. We believe that consumers have increasingly come to regard branded fashion watches not only as time pieces but also as fashion accessories. This trend has historically resulted in consumers owning multiple watches that may differ significantly in terms of style, features and cost.

Watches typically utilize either a mechanical or quartz-analog movement to maintain their time keeping function. Mechanical watches utilize intricate arrangements of wheels, jewels and winding and regulating mechanisms to keep time, while quartz-analog watches are precisely calibrated to the regular frequency of the vibration of a quartz crystal powered by a battery. Although, quartz-analog movements typically maintain their time keeping functions more precisely than mechanical movements, mechanical movements are generally associated with high-end luxury timepieces.

Fashion accessories

We believe that the fashion accessories market includes an array of products such as small leather goods, handbags, belts, eyewear, neckwear, underwear, lounge wear, jewelry, gloves, hats, hosiery and socks. We believe that consumers are becoming more aware of accessories as fashion statements, and as a result, are purchasing brand name, quality items that complement other fashion items. These fashion accessory products are generally marketed through mass merchandisers, department stores and specialty shops, depending upon price and quality. Higher price point items include products offered by such fashion names as Louis Vuitton and Prada.

Moderately priced fashion accessories are typically marketed in department stores and are characterized by contemporary fashion and well known brand names at reasonable price points, such as FOSSIL and RELIC. We currently offer small leather goods, handbags, belts, eyewear and cold weather apparel accessories for both men and women through department stores and specialty retailers in the moderate to upper-moderate price ranges. Our competitors in this market include companies such as Guess?, Nine West, Kenneth Cole and Liz Claiborne. In addition, we currently offer fashion jewelry sold under the DIESEL, EMPORIO ARMANI and FOSSIL brands.

Apparel

In 2000, we introduced a line of FOSSIL apparel that is distributed exclusively through company-owned retail stores, our FOSSIL website and through our FOSSIL catalog distribution. Selling through company-owned distribution channels allows us to more effectively manage visual presentation, information feedback, inventory levels and operating returns. The apparel line is focused on the casual lifestyle of the savvy consumer who is youthful in their approach to life and is not tied to any one demographic or age. The apparel line consists primarily of jeans, tee shirts, and vintage-inspired fashion apparel. The suggested retail selling price of the apparel line is comparable to that of major competitors like American Eagle Outfitters and J. Crew. We have leveraged our existing graphic and store design infrastructure to create a unique, inviting and welcoming environment rich in details of design, product and merchandising to appeal to the consumers' sense of discovery.

Products

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We design, develop, market and distribute fashion accessories, including apparel, belts, handbags, jewelry, small leather goods, sunglasses and watches under proprietary and licensed brand names. The following table sets forth certain information with respect to the breakdown of our net sales and percentage of growth between proprietary, licensed and other brands within our wholesale and direct to consumer distribution channels for the fiscal years indicated. Other brands include private label brands as well as branded product we purchase for resale.

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	2007		Fiscal Year Ended 2006		2005
	Dollars	% Growth	Dollars	% Growth	Dollars
Net Sales (dollars in thousands)					
Wholesale					
Proprietary	\$ 646.8	11.4%	\$ 580.6	7.2%	\$ 541.8
Licensed	453.2	34.0%	338.2	30.1%	259.9
Other	77.7	4.4%	74.4	8.6%	68.5
	1,177.7	18.6%	993.2	14.1%	870.2
Direct to consumer					