DECKERS OUTDOOR CORP
Form 10-Q
November 08, 2006

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

(Mark one)

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

For the quarterly period ended September 30, 2006

OR

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

For the transition period from __________ to __________

Commission File Number: 0-22446

DECKERS OUTDOOR CORPORATION

(Exact name of registrant as specified in its charter)

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

(805) 967-7611

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yesþ Noo

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

Large accelerated filero Accelerated filerþ Non-accelerated filero

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yeso Noþ

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

Class	Outstanding at November 2, 2006
Common Stock, $0.01 par value	12,562,228

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DECKERS OUTDOOR CORPORATION
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Condensed Consolidated Balance Sheets
(Unaudited)
(amounts in thousands, except par value)

	September 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 17,141	$ 50,749
Short-term investments	28,110	2,500
Trade accounts receivable, less allowances for doubtful accounts, sales discounts and sales returns of $5,466 and $7,149 as of September 30, 2006 and December 31, 2005, respectively	49,937	40,918
Inventories	51,530	33,374
Prepaid expenses and other current assets	2,239	1,364
Deferred tax assets	5,949	5,949
Total current assets	154,906	134,854
Property and equipment, at cost, net	5,983	4,711
Intangible assets, net	69,777	70,009
Other assets	52	52
Total assets	$ 230,718	$ 209,626
Liabilities and Stockholders Equity		
Current liabilities:		
Trade accounts payable	$ 10,304	$ 14,506
Accrued expenses	6,628	6,095
Income taxes payable	9,336	7,133
Total current liabilities	26,268	27,734
Deferred tax liabilities	4,337	4,337
Stockholders equity:		
Common stock, $.01 par value. Authorized 20,000 shares; 12,543 shares issued and outstanding at September 30, 2006; 12,432 shares issued and outstanding at December 31, 2005	125	124
Additional paid-in capital	80,350	76,788
Retained earnings	119,415	100,436
Accumulated other comprehensive income	223	207

Total stockholders equity		200,113		177,555
Total liabilities and stockholders equity	$	230,718	$	209,626

See accompanying notes to condensed consolidated financial statements.

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Condensed Consolidated Statements of Income
(Unaudited)
(amounts in thousands, except per share data)

	Three-month period ended September 30,	
	2006	**2005**
Net sales	$ 82,322	$ 69,193
Cost of sales	45,149	40,123
Gross profit	37,173	29,070
Selling, general and administrative expenses	19,865	15,052
Income from operations	17,308	14,018
Other (income) expense, net:		
Interest, net	(673)	167
Other, net	30	
Income before income taxes	17,951	13,851
Income taxes	7,352	5,701
Net income	$ 10,599	$ 8,150
Net income per share:		
Basic	$ 0.85	$ 0.66
Diluted	$ 0.83	$ 0.63
Weighted-average common shares outstanding:		
Basic	12,531	12,358
Diluted	12,831	12,856

See accompanying notes to condensed consolidated financial statements.

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Condensed Consolidated Statements of Income
(Unaudited)
(amounts in thousands, except per share data)

	Nine-month period ended September 30,	
	2006	**2005**
Net sales	$ 180,047	$ 173,797
Cost of sales	99,133	99,191
Gross profit	80,914	74,606
Selling, general and administrative expenses	50,684	41,512
Income from operations	30,230	33,094
Other (income) expense, net:		
Interest, net	(1,940)	104
Other, net	13	(3)
Income before income taxes	32,157	32,993
Income taxes	13,178	13,224
Net income	$ 18,979	$ 19,769
Net income per share:		
Basic	$ 1.52	$ 1.60
Diluted	$ 1.48	$ 1.54
Weighted-average common shares outstanding:		
Basic	12,503	12,333
Diluted	12,805	12,872

See accompanying notes to condensed consolidated financial statements.

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Condensed Consolidated Statements of Cash Flows
(Unaudited)
(amounts in thousands)

	Nine-month period ended September 30,	
	2006	**2005**
Cash flows from operating activities:		
Net income	$ 18,979	$ 19,769
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	2,264	1,792
Provision for doubtful accounts	487	1,211
Write-down of inventories	1,972	2,629
Gain on sale of property and equipment	(7)	
Non-cash stock compensation	1,555	452
Changes in assets and liabilities:		
Trade accounts receivable	(9,506)	(5,106)
Inventories	(20,128)	(39,137)
Prepaid expenses and other current assets	(875)	(23)
Other assets		521
Trade accounts payable	(4,202)	(982)
Accrued expenses	515	(2,752)
Income taxes payable	2,411	3,926
Net cash used in operating activities	(6,535)	(17,700)
Cash flows from investing activities:		
Purchases of property and equipment	(3,329)	(3,599)
Proceeds from sale of property and equipment	32	
Purchases of short-term investments	(90,684)	
Proceeds from sale of short-term investments	65,150	15,475
Net cash (used in) provided by investing activities	(28,831)	11,876
Cash flows from financing activities:		
Borrowings from line of credit		18,600
Repayments of line of credit		(5,400)
Excess tax benefits from stock-based compensation	728	
Net cash received from issuances of common stock	1,072	1,260
Net cash provided by financing activities	1,800	14,460
Effect of exchange rates on cash	(42)	66

Net change in cash and cash equivalents	(33,608)	8,702
Cash and cash equivalents at beginning of period	50,749	10,379
Cash and cash equivalents at end of period	$ 17,141	$ 19,081
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$	$ 211
Income taxes	10,442	9,296

See accompanying notes to condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements

(Unaudited)

(amounts in thousands, except share quantity and per share data)

(1) General

(a) Basis of Presentation

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

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

(b) Use of Estimates

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

(2) Stock Compensation

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

The Company s 1993 Stock Incentive Plan (the 1993 Plan) provided for 3,000,000 shares of common stock that were reserved for issuance to officers, directors, employees, and consultants of the Company. Awards to 1993 Plan participants were not restricted to any specified form and may have included stock options, securities convertible into or redeemable for stock, stock appreciation rights, stock purchase warrants, or other rights to acquire stock. Stock option awards were granted with an exercise price equal to the market price of the Company s stock at the date of grant; those option awards generally vested on a graded basis over four years of continuous service and had ten-year contractual terms. The fair value of stock options is calculated using the Black-Scholes pricing model. No stock options were granted during the three and nine months ended September 30, 2006 and

2005. The 1993 Plan was terminated in May 2006 and no new awards will be issued under this plan.

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In May 2006, the Company adopted the 2006 Equity Incentive Plan (the 2006 Plan). The primary purpose of the 2006 Plan is to encourage ownership in the Company by key personnel, whose long-term service is considered essential to the Company s continued progress. The 2006 Plan provides for 2,000,000 new shares of common stock that are reserved for issuance to employees, directors, or consultants. The maximum aggregate number of shares that may be issued under the 2006 Plan through the exercise of incentive stock options is 1,500,000. The 2006 Plan supersedes the 1993 Plan, which was subsequently terminated for new grants.

Beginning December 2004, the Company replaced its annual employee stock option grants with grants of nonvested stock units (NSUs). The NSUs granted pursuant to the 1993 Plan and the 2006 Plan entitle the employee recipients to receive shares of common stock in the Company, which vest in quarterly increments between the third and fourth anniversary of the grant. Many of these awards include vesting that is also subject to achievement of certain performance targets.

In August 1995, the Company adopted the 1995 Employee Stock Purchase Plan (the ESPP). The ESPP is intended to qualify as an Employee Stock Purchase Plan under Section 423 of the Internal Revenue Code. Under the terms of the ESPP, as amended, 300,000 shares of common stock are reserved for issuance to employees who have been employed by the Company for at least six months. The ESPP provides for employees to purchase the Company s common stock at a discount below market value, as defined by the ESPP. Under the ESPP, 8,000 shares were issued in the nine months ended September 30, 2006. The ESPP was terminated in September 2006, and no new shares will be issued under the ESPP.

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

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

As a result of our January 1, 2006 adoption of SFAS 123R, the impact to the condensed consolidated financial statements for the nine months ended September 30, 2006 on income before taxes and on net income were reductions of $133 and $79, respectively. There was a $0.01 impact on both basic and diluted earnings per share for the nine months ended September 30, 2006. In addition, prior to the adoption of SFAS 123R, the Company presented the tax benefit of stock option exercises as operating cash flows. Upon the adoption of SFAS 123R, tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows.

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The table below summarizes certain stock compensation amounts recognized in the three and nine months ended September 30, 2006 and 2005:

	Three-month period ended September 30,		Nine-month period ended September 30,	
	2006	2005	2006	2005
Compensation expense recorded for:				
Nonvested stock units	$ 329	34	$ 1,008	291
Stock options	157		379	
ESPP	56		119	
Directors shares	86	54	237	161
Total compensation expense	628	88	1,743	452
Income tax benefit recognized in income statement	(268)	(37)	(724)	(181)
Net compensation expense	$ 360	51	$ 1,019	271

A summary of the activity under the 1993 Plan and 2006 Plan as of September 30, 2006, and changes during the period are presented below.

Summary Details for 1993 Plan Share Options

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	628,000	$ 7.16		
Granted				
Exercised	(97,000)	9.28		
Forfeited or expired	(21,000)	11.55		
Outstanding at September 30, 2006	510,000	6.57	4.36	$ 20,767
Exercisable at September 30, 2006	443,000	5.12	3.97	18,694

During the nine months ended September 30, 2006 and 2005, stock options exercised totaled 97,000 and 144,000 shares, respectively, with a total intrinsic value of $2,468 and $4,904, respectively. There were no stock options granted during the nine months ended September 30, 2006 and 2005.

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Nonvested Stock Units Issued Under the 1993 Plan and 2006 Plan

	Number of Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2006	155,800	$ 30.76
Granted	22,500	36.31
Vested		
Forfeited	(13,400)	24.58
Nonvested at September 30, 2006	164,900	32.02

During the nine months ended September 30, 2006, the Company granted 8,000 NSUs under the 2006 Plan and the remaining NSUs under the 1993 Plan. As of September 30, 2006, there was $4,156 of total unrecognized compensation cost related to stock options and NSUs that will vest in the future, over a weighted-average vesting period of 2.9 years. Tax benefit realized from stock options exercised during the three months ended September 30, 2006 and 2005 was $234 and $89, respectively. The tax benefit realized for the nine months ended September 30, 2006 and 2005 was $1,012 and $1,965, respectively.

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

Pro forma information regarding the effect on net income and basic and diluted income per share for the three and nine months ended September 30, 2005, had the Company applied the fair value recognition provisions of SFAS No. 123, is as follows:

	Three-month period ended September 30, 2005	Nine-month period ended September 30, 2005
Net income as reported	$ 8,150	$ 19,769
Add stock-based employee compensation expense included in reported net income, net of tax effect	51	271
Deduct total stock-based employee compensation expense under fair value-based method for all awards, net of tax	(280)	(864)
Pro forma net income	$ 7,921	$ 19,176
Net income per share:		
Basic as reported	$ 0.66	$ 1.60
Basic pro forma	0.64	1.55
Diluted as reported	0.63	1.54
Diluted pro forma	0.62	1.50

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(3) Comprehensive Income

Comprehensive income is the total of net income and all other non-owner changes in equity. At September 30, 2006 and December 31, 2005, accumulated other comprehensive income of $223 and $207, respectively, consisted primarily of cumulative foreign currency translation adjustment.

Comprehensive income is determined as follows:

	Three-month period ended September 30,		Nine-month period ended September 30,	
	2006	2005	2006	2005
Net income	$ 10,599	8,150	$ 18,979	19,769
Unrealized loss on investments	(29)		(29)	
Cumulative foreign currency translation adjustment	(22)	(2)	45	(97)
Total comprehensive income	$ 10,548	8,148	$ 18,995	19,672

(4) Income per Share

Basic income per share represents net income divided by the weighted-average number of common shares outstanding for the period. Diluted income per share represents net income divided by the weighted-average number of shares outstanding, including the dilutive impact of potential issuances of common stock. For the three and nine-month periods ended September 30, 2006 and 2005, the difference between the weighted-average number of shares used in the basic computation and that used in the diluted computation resulted from the dilutive impact of options to purchase common stock and nonvested stock units.

The reconciliations of basic to diluted weighted-average common shares outstanding are as follows for the three and nine-month periods ended September 30, 2006 and 2005:

	Three-month period ended September 30,		Nine-month period ended September 30,	
	2006	2005	2006	2005
Weighted-a verage shares used in basic computation	12,531,000	12,358,000	12,503,000	12,333,000
Dilutive effect of stock options and nonvested stock units	300,000	498,000	302,000	539,000
Weighted-average shares used for diluted computation	12,831,000	12,856,000	12,805,000	12,872,000

All options outstanding as of September 30, 2006 were included in the computation of diluted income per share for the three and nine months ended September 30, 2006. For the three and nine months ended September 30, 2005, the Company excluded 20,000 and 10,000 options, respectively, from diluted income per

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share, because the options exercise prices were greater than the average market price of the common stock during the period, and therefore, were anti-dilutive.

The Company excluded 80,000 contingently issuable shares of common stock underlying its nonvested stock units from the diluted income per share computations for both the three and nine-month periods ended September 30, 2006 and excluded 66,000 contingently issuable shares of common stock for both the three and nine-month periods ended September 30, 2005. The shares were excluded because the necessary conditions had not been satisfied for any shares to be issuable based on the Company s performance through September 30, 2006 and 2005, respectively.

(5) Short-term Investments

Short-term investments, which primarily consist of market auction rate notes receivable, market auction rate preferred securities, and federal agency mortgage-backed securities are classified as available for sale under the provisions of SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Accordingly, the short-term investments are reported at fair value, with any unrealized gains and losses included as a separate component of stockholders equity, net of applicable taxes. Realized gains and losses, interest, and dividends are included in interest, net. Securities with original maturities of three months or less are classified as cash equivalents. Those that mature over three months but within one year are classified as short-term investments. The fair value of the Company s short-term investments at September 30, 2006 and December 31, 2005 are as follows:

	September 30, 2006		December 31, 2005	
	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Federal agency mortgage-backed securities	$ (28)	$ 12,002	$	$ 0
Auction rate securities	(1)	16,108		2,500
Total	$ (29)	$ 28,110	$	$ 2,500

(6) Credit Facility

The Company s revolving credit facility with Comerica Bank (the Facility) provides for a maximum availability of $20,000. In September 2006, the Company amended the Facility, eliminating the borrowing base formula requirement, extending the maturity date, and changing certain covenant requirements. Up to $10,000 of borrowings may be in the form of letters of credit. The Facility bears interest at the lender s prime rate (8.25% at September 30, 2006) or, at our option, at the London Interbank Offered Rate (LIBOR) (5.32% at September 30, 2006) plus 1.0% to 2.5%, depending on our ratio of liabilities to earnings before interest, taxes, depreciation and amortization, and is secured by substantially all of our assets. The Facility includes annual commitment fees of $60 per year and now expires on June 1, 2008. At September 30, 2006, the Company had no outstanding borrowings under the Facility, no foreign currency reserves for outstanding forward contracts, and outstanding letters of credit of $52. As a result, $19,948 was available under the Facility at September 30, 2006.

(7) Income Taxes

Income taxes for the interim periods were computed using the effective tax rate estimated to be applicable for the full fiscal year, which is subject to ongoing review and evaluation by management. For the three and nine months ended September 30, 2006, the Company recorded an income tax expense of $7,352 and $13,178, respectively, representing an effective income tax rate of 41.0% for both periods. For the three and nine

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months ended September 30, 2005, the Company recorded an income tax expense of $5,701 and $13,224, respectively, representing an effective income tax rate of 41.2% and 40.1%, respectively.

(8) Recent Accounting Pronouncements

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

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

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

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of SFAS No. 109, which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. FIN 48 also provides guidance on the derecognition, classification, accounting in interim periods, and disclosure requirements for uncertain tax positions. The provisions of FIN 48 are effective for the Company as of January 1, 2007. The Company is currently evaluating the impact of adopting FIN 48, if any, on the Company s consolidated financial statements.

In September 2006, the FASB issued Statement No. 157 (SFAS 157), Fair Value Measurements. SFAS 157 standardizes the definition and approaches for fair value measurements of financial instruments for those standards which already permit or require the use of fair value. It does not require any new fair value measurements. SFAS 157 defines a hierarchy for valuation techniques and also requires additional disclosures. The provisions of SFAS 157 are effective for the Company as of January 1, 2008. The Company does not expect the adoption of this statement to have a material effect on its consolidated financial statements.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. It requires companies to quantify the misstatements using both a balance sheet and an income statement approach. SAB 108 is effective for the Company s fiscal year

ending December 31, 2006. The Company does not expect that SAB 108 will have a material impact on its consolidated financial statements.

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(Unaudited)
(amounts in thousands, except share quantity and per share data)

(9) Business Segments, Concentration of Business, and Credit Risk and Significant Customers

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

Net sales and operating income (loss) by business segment for the three and nine months ended September 30, 2006 and 2005 are summarized as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
Net sales to external customers:				
Teva wholesale	$ 8,515	8,432	62,915	69,775
UGG wholesale	63,995	55,454	90,912	86,195
Simple wholesale	3,996	1,941	9,889	5,989
Consumer Direct	5,816	3,366	16,331	11,838
	$ 82,322	69,193	180,047	173,797

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
Income (loss) from operations:				
Teva wholesale	$ 1,112	1,242	$ 17,874	20,896
UGG wholesale	24,040	18,449	33,262	27,511
Simple wholesale	(648)	(260)	(892)	(27)
Consumer Direct	1,034	577	3,869	2,506
Unallocated overhead costs	(8,230)	(5,990)	(23,883)	(17,792)

$ 17,308	14,018	$ 30,230	33,094

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Business segment asset information as of September 30, 2006 and December 31, 2005 is summarized as follows:

	September 30, 2006	December 31, 2005
Total assets for reportable segments:		
Teva wholesale	$ 76,738	$ 83,901
UGG wholesale	89,580	56,907
Simple wholesale	6,918	5,211
Consumer Direct	1,360	945
	$ 174,596	$ 146,964

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

Reconciliations of total assets from reportable segments to the condensed consolidated balance sheets at September 30, 2006 and December 31, 2005 are as follows:

	September 30, 2006	December 31, 2005
Total assets for reportable segments	$ 174,596	$ 146,964
Unallocated deferred tax assets	5,949	5,949
Other unallocated corporate assets	50,173	56,713
Consolidated total assets	$ 230,718	$ 209,626

The Company sells its footwear products principally to customers throughout the U.S. The Company also sells its footwear products to foreign customers located in Europe, Canada, Australia, Asia, and Latin America among other regions. International sales to unaffiliated customers were 10.9% and 13.2% of net sales for the three months ended September 30, 2006 and 2005, respectively. International sales were 15.9% and 16.5% of net sales for the nine months ended September 30, 2006 and 2005, respectively. The Company does not consider international operations a separate segment, as management reviews such operations in the aggregate with the aforementioned segments. Management performs regular evaluations concerning the ability of its customers to satisfy their obligations and records a provision for doubtful accounts based upon these evaluations. An upscale department store based on the West Coast of the U.S., which is a significant customer for each of our three brands, accounted for 11.2% of our net sales for both the nine months ended September 30, 2006 and 2005. No other customer accounted for more than 10% of net sales in the nine months ended September 30, 2006 and 2005. As of September 30, 2006 and December 31, 2005, the Company had one customer representing 19.6% and 27.6%, respectively, of net trade accounts receivable.

As of September 30, 2006, approximately $17,000 of trademarks and $466 of goodwill are held in Hong Kong by a subsidiary of the Company. Substantially all other long-lived assets are held in the U.S.

The Company s production and sourcing is concentrated primarily in the Far East, with the vast majority being produced at five independent contractor factories in China. The Company s operations are subject to the customary risks of doing business abroad, including, but not limited to, currency fluctuations, customs

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duties and related fees, various import controls and other nontariff barriers, restrictions on the transfer of funds, labor unrest and strikes and, in certain parts of the world, political instability.

(10) Contingencies

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

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

Forward-Looking Statements

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

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

We have based our forward-looking statements largely on our current expectations and projections about future events and financial trends affecting our business. Actual results may differ materially. Some of the risks, uncertainties and assumptions that may cause actual results to differ from these forward-looking statements are described in our Annual Report on Form 10-K under Item 1A. *Risk Factors* and in this quarterly report on Form 10-Q under Item 1A. *Risk Factors*. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report and the information incorporated by reference in this report might not happen.

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

The Deckers, UGG, Teva, and Simple families of related marks, images and symbols are our trademarks and intellectual property. Other trademarks, trade names and service marks appearing in this report are the property of their respective holders. References to Deckers, we, us, our, or similar terms refer to Deckers Outdoor Corporation together with its consolidated subsidiaries. Unless otherwise specifically indicated, all dollar amounts herein are expressed in thousands, except for weighted-average wholesale prices per pair.

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Overview

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

Teva: High performance sport sandals and rugged outdoor footwear;

UGG: Authentic luxury sheepskin boots and a full line of luxury and comfort footwear; and

Simple: Innovative sustainable lifestyle footwear and accessories.

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

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

The markets for casual, outdoor and athletic footwear have grown significantly during the last decade. We believe this growth is a result of the trend toward casual dress in the workplace, increasingly active outdoor lifestyles and a growing emphasis on comfort.

Consumers are more often seeking footwear designed to address a broader array of activities with the same quality, comfort and high performance attributes they have come to expect from traditional athletic footwear.

Our customers have narrowed their footwear product breadth, focusing on brands with a rich heritage and authenticity as market category creators and leaders.

Consumers have become increasingly focused on luxury and comfort, seeking out products and brands that are fashionable while still comfortable.

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

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

Teva Overview

We initially produced Teva products under a license from the inventor of the Teva Universal Strap technology, Mark Thatcher. In November 2002, we purchased from Mr. Thatcher the Teva worldwide assets, including the Teva internet and catalog business and all patents, trade names, trademarks and other intellectual property associated with the acquired Teva assets, or the Teva Rights.

From fiscal 2001 to 2004, Teva s wholesale net sales increased at a compound annual growth rate of 10.9%. However, for the fiscal year 2005 and the nine months ended September 30, 2006, Teva wholesale net sales decreased by approximately 3.6% and 9.8%, respectively, compared to the year ago periods. We attribute this decline in sales primarily to a lack of new product innovation, coupled with a significant increase in competitor activity. We have begun to address this situation by dedicating significantly greater resources to product planning, design, and development and our efforts began to take effect in the current quarter. We also had higher full price sales in the current quarter. For the third quarter of 2006, Teva s wholesale net sales increased

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by 1.0% compared to the third quarter of 2005. However, given the lead times required for new products to yield results, we do not expect growth for Teva in 2006, but expect to return to positive year over year growth in 2007. Despite the decrease in sales for 2006, we expect Teva will finish the year in a much stronger position than it was in 2005. In the second half of 2005, steps were taken to reduce inventory of old Teva product. Beginning in the first quarter of 2006, we significantly increased our investment in measurable media (advertising and in-store display materials). We shifted the target of our advertising to a younger, trend-setting consumer. We also introduced a modest collection of new styles for both Spring and Fall 2006. As a result, closeout sales represented a significantly smaller percentage of total sales.

We see a continuing shift in consumer preferences and lifestyles to include more outdoor recreational activities. Teva has remained popular among professional and amateur outdoor enthusiasts, who consider the brand authentic and performance oriented. Our Spring 2007 product line is over 70% new, and includes innovative technical performance styles, as well as new colors and fresh new casual styles, which target a new generation of young outdoor athletes and enthusiasts.

To further capitalize on the growth of outdoor recreational activities and the acceptance of certain outdoor footwear products for everyday use, we will continue to explore opportunities to broaden Teva s distribution with image-enhancing retailers beyond our core outdoor specialty and sporting goods channels. Through effective channel management, we believe we can continue to expand into new distribution channels without diluting our outdoor heritage and our appeal to outdoor enthusiasts. Through appropriate channel product line expansion, we plan to continue to broaden our product offerings beyond sport sandals to new products that meet the style and functional needs of our consumers.

UGG Overview

UGG has been a well-known brand in California for many years and over the past few years has become a recognized brand throughout the remainder of the country. Since early 2003, our UGG brand has received increased media exposure including increased print media in national ads and coop advertising with our customers, which contributed to broader public awareness of the UGG brand and significantly increased demand for the collection. We believe that the increased media focus and demand on UGG was driven by the following:

- UGG footwear is luxurious and comfortable, which has created brand loyalty,
- increased marketing in high end magazines,
- successfully targeting high end distribution,
- adoption by high-profile film and television celebrities as a favored footwear brand,
- increased media attention that has enabled us to introduce the brand to consumers much faster than we would have normally been able to,
- continued geographic expansion across the U.S., and
- continued addition of new product categories.

We believe the luxury and comfort features of UGG products will continue to drive long-term consumer demand. Recognizing that there is a significant fashion element to UGG and that footwear fashions fluctuate, our strategy seeks to prolong the longevity of the brand by offering a broader product line suitable for wear in a variety of climates and occasions and by limiting distribution to selected higher-end retailers. As part of this strategy, we have doubled our product line to approximately 100 styles in 2006 from approximately 50 styles in 2002. This product line expansion includes our significantly expanded Spring and Fall 2006 Fashion Collection and Men s offering, as well as new styles

in our Driving Collection, our newly introduced Surf Collection, our Cold Weather Collection and our luxury slipper category. Nevertheless, we cannot assure investors that UGG sales will continue to grow at their recent pace or that revenue from UGG products will not at some point decline. For the three months ended September 30, 2006, UGG wholesale sales increased 15.4%

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over the same period in 2005. For the nine months ended September 30, 2006, UGG wholesale sales increased 5.5% compared to the same period in 2005.

Simple Overview

Simple Shoes began in 1991 as an alternative to all the over-built, over-priced, and over-hyped products in the marketplace. The brand s foundation was built on the Old School Sneaker and the New Original Clog. In 2005, the Simple product line focused on rebuilding the segments that made the brand successful: clogs and sneakers. In Fall 2005, as a response to the massive amount of waste produced by the footwear industry, Simple launched a new collection of ecologically friendly footwear called Green Toe, a product collection that consists of 100% sustainable materials and is revolutionizing the footwear industry. We have re-positioned the brand to be the world leader in sustainable footwear and accessories. In 2005, we also hired an in-house public relations manager, increased our print media campaigns, as well as improved our distribution initiatives through the establishment of dedicated sales representatives in key markets. These strategies, combined with innovative products and unique marketing, have created greater trust amongst our retailers, which is something that previously marked a challenge for the brand based on past performance. It is more apparent now that the brand is dedicated to creating a cohesive and consistent message to both the retailer and consumer. In the first nine months of 2006, our men s and women s products performed well at retail, and demand continues to increase for our Green Toe products. We increased our account base both domestically and internationally. We also expanded our presence into additional retail stores with our key accounts. These efforts resulted in an increase of Simple s wholesale net sales of 105.9% and 65.1% in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005. Simple s mission is to be the world leader in sustainable footwear and accessories as we continue to bring fresh product designs to the market and successfully implement our sales strategy to expand distribution channels.

Consumer Direct Overview

Our Consumer Direct business includes our internet and catalog retailing operations as well as our retail outlet stores. We acquired our internet and catalog retailing business in November 2002 as part of the acquisition of the Teva rights. In addition, we have opened two new retail outlet stores, one in Camarillo, California and one in Wrentham, Massachusetts, along with our existing store in Ventura, California. Based on the success of the existing stores, we currently expect to open two to three additional retail outlet stores in select premium outlet malls in the U.S. by the end of 2007, as well as an UGG concept store in New York City by the end of 2006. Our Consumer Direct business, which today sells all three of our brands, enables us to meet the growing demand for these products, to sell the products at retail prices and to provide us with significant incremental operating income. From the time we initiated our Consumer Direct business through the third quarter of 2006, we have had significant revenue growth, much of which occurred as the underlying brands gained popularity, as consumers have continued to increase reliance on the internet for footwear and other purchases and as we began to open retail outlet stores. Net sales of the Consumer Direct business increased 72.8% and 38.0%, in the three and nine months ended September 30, 2006, respectively, compared to the same periods in 2005.

Managing our internet business requires us to focus on generating internet traffic to our websites, to effectively convert website visits into orders, and to maximize average order sizes. We distribute approximately two million consumer brochures throughout the year to drive our catalog order business. We plan to continue to grow this business through improved website features and performance, increased marketing, European websites, and the trend of internet shopping becoming more popular. Overall, our Consumer Direct business benefits from the strength of our brands and, as we grow our brands over time, we expect this business to continue to be an important segment of our business.

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Licensing Overview

In 2004, we embarked on a strategy to license our footwear brands to complementary products outside of footwear, generally in the apparel and accessories categories. We currently have eleven licensing agreements with six licensees for Teva and UGG combined. The activity is very small in relation to the consolidated operations. We do not expect significant incremental net sales and profits from licensing in the near future.

Seasonality

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

	2006		
	First Quarter	Second Quarter	Third Quarter
Net sales	$56,004	$41,721	$82,322
Income from operations	$ 8,914	$ 4,008	$17,308

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

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

Given our expectations for each of our brands in 2006, we currently expect this seasonality trend to continue. Nonetheless, actual results could differ materially depending upon consumer preferences, whether the UGG brand will continue to grow at the rate it has experienced in the recent past, availability of product, competition, and our customers continuing to carry and promote our various product lines, among other risks and uncertainties. Please refer to our Annual Report on Form 10-K under Item 1A. *Risk Factors* and this quarterly report on Form 10-Q under Item 1A. *Risk Factors*.

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Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Net sales by location:				
U.S.	$ 73,344	$ 60,058	$ 151,385	$ 145,088
International	8,978	9,135	28,662	28,709
Total	$ 82,322	$ 69,193	$ 180,047	$ 173,797
Net sales by product line and Consumer Direct business:				
Teva:				
Wholesale	$ 8,515	$ 8,432	$ 62,915	$ 69,775
Consumer Direct	1,501	1,316	4,576	4,200
Total	10,016	9,748	67,491	73,975
UGG:				
Wholesale	63,995	55,454	90,912	86,195
Consumer Direct	3,898	1,878	10,665	6,986
Total	67,893	57,332	101,577	93,181
Simple:				
Wholesale	3,996	1,941	9,889	5,989
Consumer Direct	417	172	1,090	652
Total	4,413	2,113	10,979	6,641
Total	$ 82,322	$ 69,193	$ 180,047	$ 173,797

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Income (loss) from operations by product line and Consumer Direct business:				
Teva wholesale	$ 1,112	$ 1,242	$ 17,874	$ 20,896
UGG wholesale	24,040	18,449	33,262	27,511
Simple wholesale	(648)	(260)	(892)	(27)
Consumer Direct	1,034	577	3,869	2,506

Unallocated overhead costs	(8,230)	(5,990)	(23,883)	(17,792)
Total	$ 17,308	$ 14,018	$ 30,230	$ 33,094

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

	Three Months Ended September 30,		Percent Change 2006 to 2005
	2006	**2005**	
Net sales	100.0%	100.0%	19.0%
Cost of sales	54.8	58.0	12.5
Gross profit	45.2	42.0	27.9
Selling, general and administrative expenses	24.1	21.8	32.0
Income from operations	21.1	20.3	23.5
Other (income) expense, net	(0.8)	0.2	*
Income before income taxes	21.8	20.0	29.6
Income taxes	8.9	8.2	29.0
Net income	12.9%	11.8%	30.0%

	Nine Months Ended September 30,		Percent Change 2006 to 2005
	2006	**2005**	
Net sales	100.0%	100.0%	3.6%
Cost of sales	55.1	57.1	(0.1)
Gross profit	44.9	42.9	8.5
Selling, general and administrative expenses	28.2	23.9	22.1
Income from operations	16.8	19.0	(8.7)
Other (income) expense, net	(1.1)	0.1	*
Income before income taxes	17.9	19.0	(2.5)
Income taxes	7.3	7.6	(0.3)
Net income	10.5%	11.4%	(4.0)%

* Calculation of percentage change is not meaningful.

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

Overview. For the three months ended September 30, 2006, we had net sales of $82,322 and income from operations of $17,308 compared to net sales of $69,193 and income from operations of $14,018 for the three months ended September 30, 2005. These improved results were primarily due to an increase in UGG and Simple sales. Income from operations increased as a result of increased net sales and gross margins, partially offset by the increase in selling, general and administrative expenses.

Net Sales. Net sales increased by $13,129 or 19.0%, for the three months ended September 30, 2006 compared to the three months ended September 30, 2005. This increase is due primarily to the increase in UGG and Simple sales. In addition, our weighted-average wholesale selling price per unit increased 1.7% to $40.46 for the three months ended September 30, 2006 from $39.77 for the three months ended September 30, 2005, resulting primarily from higher UGG sales, which generally carry a higher average selling price, as well as lower closeout sales during the three months ended September 30, 2006. During the quarter, we experienced increases in the number of units sold of UGG and Simple, as well as a slight increase in the number of

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sold of Teva resulting in a 16.9% overall increase in the volume of footwear sold to 2.0 million pairs for the three months ended September 30, 2006 from 1.7 million pairs for the three months ended September 30, 2005.

Net wholesale sales of Teva increased by $83, or 1.0%, for the three months ended September 30, 2006 compared to the three months ended September 30, 2005 primarily due to higher full price sales and higher weighted-average wholesale selling prices per unit. Teva s performance was driven by a positive reaction to a limited introduction of closed toe footwear combined with solid sales of our traditional sandals. See Overview Teva Overview above.

Net wholesale sales of UGG increased by $8,541, or 15.4%, for the three months ended September 30, 2006 compared to the three months ended September 30, 2005, due primarily to strong consumer demand for our new Fall product line and new introductions combined with a strong reorder business for core p