FOSSIL INC
Form S-3/A
May 12, 2004

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**As filed with the Securities and Exchange Commission on May 12, 2004**

**Registration No. 333-113868**

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# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

**AMENDMENT NO. 2 TO**

# FORM S-3

**REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933**

# FOSSIL, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **75-2018505** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification Number) |

**2280 North Greenville Avenue, Richardson, Texas 75082**
**(972) 234-2525**

(Address, including zip code, and telephone number, including area code, of registrant's principal executive officers)

**T.R. Tunnell, Esq.**
**Executive Vice President and Chief Legal Officer**
**2280 North Greenville Avenue**
**Richardson, Texas 75082**
**(972) 699-2139**

(Name, address, including zip code, and
telephone number, including area code, of agent for service)

*Copy to:*

| | |
|---|---|
| **Ronald J. Frappier, Esq.**<br>**Jenkens & Gilchrist,**<br>**a Professional Corporation**<br>**1445 Ross Avenue, Suite 3200**<br>**Dallas, Texas 75202-2799**<br>**(214) 855-4500** | **Luciana Fato, Esq.**<br>**Davis Polk & Wardwell**<br>**450 Lexington Avenue**<br>**New York, New York 10017**<br>**(212) 450-4000** |

**Approximate date of commencement of proposed sale to the public:** At such time or times after the effective date of this Registration Statement as the selling stockholders may determine.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. o

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reimbursement plans, check the following box. o

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act of 1933, please check the following box and list the Securities Act of 1933 registration number of the earlier effective registration statement for the same offering. o

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act of 1933, check the following box and list the Securities Act of 1933 registration number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to Section said 8(a), may determine.**

**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**Subject to Completion, dated May 12, 2004**

**Prospectus**

## 6,525,000 *shares*

# FOSSIL, INC.

***Common Stock***

The selling stockholders identified in this prospectus are selling 6,525,000 shares of our common stock. We will not receive any proceeds from the sale of the shares by the selling stockholders.

Our common stock is traded on the Nasdaq National Market under the symbol "FOSL." On May 11, 2004, the last reported sale price for our common stock was $24.03.

| | Per share | Total |
|---|---|---|
| Public offering price | $ | $ |
| Underwriting discounts and commissions | $ | $ |
| Proceeds to the selling stockholders, before expenses | $ | $ |

The selling stockholders have granted the underwriters an option for a period of 30 days to purchase up to 978,750 additional shares.

**Investing in our common stock involves risks. See "Risk factors" beginning on page 4.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed on the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

**JPMorgan**

**Jefferies & Company, Inc.** **CIBC World Markets**

, 2004

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You should rely on the information contained in this prospectus. Neither we nor the selling stockholders have authorized anyone to provide you with information different from that contained in this prospectus. The selling stockholders are offering to sell, and seeking offers to buy, shares of our common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock.

No action is being taken in any jurisdiction outside the United States to permit a public offering of the common stock or possession or distribution of this prospectus in that jurisdiction. Persons who come into possession of this prospectus in jurisdictions outside the United States are required to inform themselves about and to observe any restrictions as to this offering and the distribution of this prospectus applicable to that jurisdiction.

## Prospectus summary

*This summary highlights material information contained elsewhere in this prospectus. For a more complete understanding of this offering, we encourage you to read this entire document and the documents we refer you to, including documents incorporated by reference herein. You should read the following summary together with the more detailed information and financial statements and the notes to those statements appearing elsewhere and incorporated by reference in this prospectus. Except as otherwise noted, we present all financial and operational data on a fiscal year and fiscal quarter basis. Our fiscal years 2003, 2002 and 2001 ended January 3, 2004, January 4, 2003 and January 5, 2002, respectively. Our first fiscal quarter for 2004 ended April 3, 2004. Our fiscal quarters for 2003 ended April 5, 2003, July 5, 2003, October 4, 2003 and January 3, 2004. Our fiscal quarters for 2002 ended April 6, 2002, July 6, 2002, October 5, 2002 and January 4, 2003.*

**Fossil, Inc.**

We are a leader in the design, development, marketing and distribution of contemporary, high quality fashion watches and accessories. We developed the FOSSIL® brand name to convey a distinctive fashion, quality and value message and a brand image reminiscent of an earlier era that suggests a time of fun, fashion and humor. Since our inception in 1984, we have grown into a diversified company offering fashion watches under our FOSSIL, RELIC® and ZODIAC® brands and, pursuant to license agreements, under some of the most prestigious brands in the world including:

- BURBERRY®;
- DIESEL®
- DKNY®; and
- EMPORIO ARMANI®.

Additionally, we offer a wide range of accessories under the FOSSIL and RELIC brands including:

- belts
- handbags
- small leather goods; and
- sunglasses.

We also offer jewelry under the FOSSIL and EMPORIO ARMANI brands and FOSSIL brand apparel. We leverage our centralized design/development and production/sourcing expertise by distributing these products through our global distribution network.

We sell our products:

- in approximately 20,500 retail locations in the United States through a diversified distribution network that includes approximately 7,500 department store doors, such as Federated/Macy's, Saks, Nordstroms, May Department Stores and Dillard's for our FOSSIL brand and certain licensed brands and JCPenney, Kohls and Sears for our RELIC brand;

in approximately 13,000 specialty retail locations;

through a network of 98 stores owned by us within the United States, of which 44 retail stores are located in premier retail sites and 54 outlet stores are located in major outlet malls;

at our website, www.fossil.com;

at retail locations in major airports in the United States;

on cruise ships and airlines; and

in certain international markets in authorized FOSSIL retail stores and kiosks either owned by us or independently owned.

Our products are sold to department stores and specialty retail stores in over 90 countries worldwide through foreign sales subsidiaries owned by us and through a network of approximately 60 independent distributors. Our products can be found in Australia, Canada, the Caribbean, Central and South America, Europe, the Far East, Mexico, the Middle East and South Africa.

**Business strategy**

Our long-term goal is to capitalize on the strength of our growing consumer brand recognition and capture an increasing share of a growing number of markets by providing consumers with fashionable, high quality, value-driven products. In pursuit of this goal, we have adopted operating and growth strategies that provide the framework for our future growth while maintaining the consistency and integrity of our brands.

**Operating strategy**

Our operating strategy is based on product development, including design innovation, product promotion and product value, and the effective management of our supply, sale and distribution chains. To implement our strategy, we offer a variety of brands and product categories, each of which is adjusted several times a year to respond to fashion trends. We also coordinate our marketing efforts in order to effectively communicate to our target markets our themes and the images associated with our brands. We aim to sell our products at retail prices generally below those of competitive products of comparable quality. We have long term relationships with manufacturers in the Far East and own a majority interest in a number of watch assemblers with locations in China. We additionally actively manage our retail sales by monitoring sales and inventory levels and assisting retailers with their marketing programs. We believe that our 10 warehouse and distribution centers enable us to reduce inventory risk and provide us with increased flexibility in meeting customer requirements.

**Growth strategy**

Our growth strategy consists for four key elements. In particular, we aim to:

- Introduce new products and brands
- Expand our international business
- Leverage our infrastructure
- Expand our retail locations

**Recent developments**

On March 23, 2004, we entered into an agreement to acquire Tempus International Corp. for approximately $50 million in cash. Tempus, which does business as Michele Watches, is based in Miami, Florida and manufactures, markets and distributes luxury watches under the MW® and MW Michele® brand labels. Michele Watches distributes its products primarily in the U.S. with a growing presence in Asia. Michele's MW brand, launched as a fine watch brand in the United States in the fall of 2000, with its CSX Diamond Collections, quickly became a leader in the luxury watch category at retailers including Neiman Marcus, Saks Fifth Avenue and better independent retailers. The acquisition was consummated on April 8, 2004.

On April 19, 2004, we entered into a license agreement with Michael Kors (USA), Inc. to design, develop and distribute a line of women's and men's timepieces under the MICHAEL Michael Kors® label. The timepieces are set to debut in Fall 2004. Michael Kors is recognized as one of America's pre-eminent designers for luxury sportswear. His namesake company, established in 1981, currently produces a range of products through his Michael Kors Collection, KORS Michael Kors, and soon to be launched MICHAEL Michael Kors labels, including men's and women's ready to wear, women's accessories and a line of fragrance and beauty products for both women and men.

**Corporate information**

Our company is a Delaware corporation formed in 1991 and is the successor to a Texas corporation formed in 1984. We conduct a majority of our operations in the United States through Fossil Partners, L.P., a Texas limited partnership formed in 1994 of which our company is the sole general partner. We also conduct operations in the United States and certain international markets through various directly and indirectly owned subsidiaries. Our operations in Hong Kong relating to the procurement of watches from various manufacturing sources are conducted by Fossil (East) Ltd., our wholly owned subsidiary acquired in 1992. Our principal executive offices are located at 2280 N. Greenville Avenue, Richardson, Texas 75082, and our telephone number at that address is (972) 234-2525. Our Internet address is www.fossil.com. The contents of our website are not a part of this prospectus.

**The offering**

| | |
|---|---|
| Common stock offered by: | |
| Mr. Tom Kartsotis | 5,220,000 shares |
| Mr. Kosta Kartsotis | 1,305,000 shares |
| Common stock outstanding before and after this offering | 70,538,472 shares |
| Over-allotment option: | |
| From Mr. Tom Kartsotis | 783,000 shares |
| From Mr. Kosta Kartsotis | 195,750 shares |
| Use of proceeds | We will not receive any proceeds from the sale of common stock by the selling stockholders |
| Nasdaq National Market symbol | FOSL |

The above information regarding shares outstanding before and after the offering is based on the number of shares of common stock outstanding as of May 11, 2004.

The number of shares outstanding also excludes: options to purchase 5,873,876 shares of common stock issued under our 1993 Long-Term Incentive Plan, of which 2,247,444 are currently exercisable at an average price of $5.65, and options to purchase 293,250 shares of common stock issued under our Nonemployee Director Plan, of which 270,000 are currently exercisable at an average price of $5.60.

## Risk factors

***You should carefully consider the risks described below before making an investment decision. If any of the following risks actually occur, our business, financial condition or results of operations could be materially adversely affected. This could cause a decline in the trading price of our common stock, and you may lose all or part of your investment.***

***Our success depends upon our ability to anticipate and respond to changing fashion trends.***

Our success depends upon our ability to anticipate and respond to changing fashion trends and consumer preferences in a timely manner. Although we attempt to stay abreast of emerging lifestyle and fashion trends affecting accessories and apparel, any failure by us to identify and respond to such trends could adversely affect consumer acceptance of our existing brand names and product lines, which in turn could adversely affect sales of our products. If we misjudge the market for our products, we may be faced with a significant amount of unsold finished goods inventory. Additionally, we have recently expanded and intend to further expand the scope of our product offerings, and there can be no assurance that new products introduced by us will achieve consumer acceptance comparable to that of our existing product lines.

***The effects of economic cycles, terrorism, acts of war and retail industry conditions may adversely affect our business.***

Our business is subject to economic cycles and retail industry conditions. Purchases of discretionary fashion accessories, such as our watches, handbags, sunglasses and other products, tend to decline during recessionary periods when disposable income is low and consumers are hesitant to use available credit. In addition, acts of terrorism, acts of war and military action both in the United States and abroad can have a significant effect on economic conditions. Any significant declines in general economic conditions or uncertainties regarding future economic prospects that affect consumer spending habits could have a material adverse effect on consumer purchases of our products.

***We extend unsecured credit to our customers and are therefore vulnerable to any financial difficulties they may face.***

We sell our merchandise primarily to department stores and specialty retail stores in over 90 countries worldwide. We extend credit based on an evaluation of each customer's financial condition, usually without requiring collateral. Should any of our larger customers experience financial difficulties, we could curtail business with such customers or assume more credit risk relating to such customers' receivables. Our inability to collect on our trade accounts receivable relating to such customers could have a material adverse effect on the amount of revenues that we receive.

***We do not maintain long-term contracts with our customers and are unable to control their purchasing decisions.***

We do not maintain long-term purchasing contracts with our customers and therefore have no contractual leverage over their purchasing decisions. A decision by a major department store or other significant customer to decrease the amount of merchandise purchased from us or to cease carrying our products could have a material adverse effect on our revenues and operating strategy.

***Our ability to continue our sales growth is dependent upon the implementation of our growth strategy, which we may not be able to achieve.***

During recent years, we have experienced rapid and substantial growth in sales. Our ability to continue this growth is dependent on the successful implementation of our business strategy. This includes diversification of our product offerings, expansion of our company-owned Fossil retail and outlet locations and certain strategic acquisitions. There can be no assurance that the expansion of our product offerings will be successful or that new products will be profitable or generate sales comparable to those of our existing businesses. Another element of our business strategy is to place increased emphasis on growth in selected international markets. There can be no assurance that our brand names and products will achieve a high degree of consumer acceptance in these markets.

We also operate stores under the FOSSIL brand and have historically expanded our company-owned FOSSIL retail and outlet locations to further strengthen our brand image. We currently operate approximately 120 stores, with a majority of the stores located in the United States. The costs associated with leasehold improvements to current stores and the costs associated with opening new stores could materially increase our costs of operation, particularly if we decide to open more stores on a yearly basis than our historical averages.

Finally, as part of our growth strategy, we have made certain acquisitions, domestically and internationally, including acquisitions of FOSSIL stores operated under license agreements, acquisitions of certain watch brands, and acquisitions of independent distributors of our products. There can be no assurance that the integration of acquisitions will be successful or that acquisitions will generate sales increases.

***Foreign currency fluctuations could adversely impact our financial condition.***

We generally purchase our products in U.S. dollars. However, we source a significant amount of our products overseas and, as such, the cost of these products purchased by our subsidiaries may be affected by changes in the value of the currencies, including the Australian Dollar, British Pound, Canadian Dollar, Euro, Japanese Yen, Malaysian Ringgit and Singapore Dollar. Changes in the currency exchange rates may also affect the relative prices at which we and our foreign competitors sell products in the same market. Although we utilize forward contracts to mitigate foreign currency risks (mostly relating to the Euro and the British Pound), there can be no assurance that foreign currency fluctuations will not have a material adverse impact on the amount of revenue we are able to generate from our overseas business.

***Access to suppliers that are not Fossil subsidiaries is not guaranteed because we do not maintain long-term contracts but instead rely on long-standing business relationships, which may not continue in the future.***

A majority of our watch products are currently manufactured to our specifications by company-owned subsidiaries in China and, to a lesser extent, by owned or independent manufacturers in China, Hong Kong and Switzerland. Certain of our other products are currently manufactured to our specifications by independent manufacturers in China, Hong Kong, Italy, Korea, Mexico and Taiwan. We have no long-term contracts with these independent manufacturing sources and compete with other companies for production facilities. All transactions between us and our independent manufacturing sources are conducted on the basis of purchase orders. Although we believe that we have established close relationships with our principal independent manufacturing sources, our future success will depend upon our ability to maintain close relationships with our current suppliers and to develop long-term relationships with other suppliers that satisfy our requirements for price, quality and production flexibility. Further, although we periodically visit and monitor the operations of independent manufacturers and require them to operate in compliance with applicable laws and regulations and promote ethical business practices, we do not control these manufacturers or their labor practices. The violation of labor or other laws by an independent manufacturer, or the divergence of an independent manufacturer's labor practices from those generally accepted as ethical in the United States, could interrupt, or otherwise disrupt, the shipment of finished products to us or damage our reputation, each of which could have a material adverse effect on consumer purchases of our products.

***Because we are dependent on foreign manufacturing we are vulnerable to changes in economic and social conditions in Asia and disruptions in international travel and shipping.***

Because a substantial portion of our watches and certain of our handbags, sunglasses and other products are manufactured in Hong Kong and China, our success will depend to a significant extent upon future economic and social conditions existing in Hong Kong and China. If the manufacturing sources in Hong Kong and China were disrupted for any reason, we would need to arrange for the manufacture and shipment of products by alternative sources. Because the establishment of new manufacturing relationships involves numerous uncertainties, including those relating to payment terms, costs of manufacturing, adequacy of manufacturing capacity, quality control and timeliness of delivery, we are unable to predict whether such relationships would be on terms that we regard as satisfactory. Any significant disruption in our relationships with our manufacturing sources located in Hong Kong and China would have a material adverse effect on our ability to manufacture and distribute our products. Restrictions on travel to and from these and other regions, similar to those imposed during the outbreak of Severe Acute Respiratory Syndrome in 2003, commonly known as SARS, and any delays or cancellations of customer orders or the manufacture or shipment of our products on account of SARS or other syndromes could have a material adverse effect on our ability to meet customer deadlines and timely distribute our products in order to match consumer tastes.

***Our competitors are established companies that have greater experience than us in a number of crucial areas, including design and distribution.***

There is intense competition in each of the businesses in which we compete. Our moderately priced watch business competes with a number of established manufacturers, importers and distributors such as Guess?, Anne Klein II, Kenneth Cole and Swatch. Our fine premium branded and designer watch business competes with a number of established manufacturers, importers and distributors such as Gucci, Rado, Raymond Weil, Seiko and Swiss Army. In addition, our leather goods, sunglass, jewelry and apparel businesses compete with a large number of established companies that have significantly greater experience than us in designing, developing, marketing and distributing such products. In all of our businesses, we compete with numerous manufacturers, importers and distributors who may have significantly greater financial, distribution, advertising and marketing resources than us. Our competitors include distributors that import watches, accessories and apparel from abroad, domestic companies that have established foreign manufacturing relationships and companies that produce accessories and apparel domestically.

***Our implementation of a new enterprise resource planning system could disrupt our computer system and divert management time.***

We are currently implementing an enterprise resource planning system from SAP AG, a German software company. Over the next few years, we intend to replace our existing enterprise resource planning systems and other principal financial systems with software systems provided by SAP AG. During 2003, we implemented the new enterprise resource planning system in our U.S. and Canada locations and over the next few years intend to replace our existing enterprise resource planning systems and principal financial systems at our international subsidiaries with software systems provided by SAP AG. Our current expansion plans may place significant strain on our management, working capital, financial and management control systems and staff. The failure to maintain or upgrade financial and management control systems, to recruit additional staff or to respond effectively to difficulties encountered during expansion could have a material adverse effect on our ability to respond to trends in our target markets, market our products and meet customer deadlines. The sustained disruption or failure of our systems due to force majeure or as part of an upgrade, conversion or other systems maintenance could result in the same adverse effects.

***We have key facilities in the United States and overseas, the loss of any of which could harm our business.***

Our administrative and distribution operations in the United States are conducted primarily from two separate facilities located in the Dallas, Texas area. Our operations internationally are conducted from various administrative, distribution and manufacturing facilities outside of the United States, particularly in Germany and Hong Kong. The complete or temporary loss of use of all or part of these facilities could have a material adverse effect on our business.

***Seasonality of our business may adversely affect our net sales and operating income.***

Our quarterly results of operations have fluctuated in the past and may continue to fluctuate as a result of a number of factors, including seasonal cycles, the timing of new product introductions, the timing of orders by our customers and the mix of product sales demand. Our business is seasonal by nature. A significant portion of our net sales and operating income are generated during the fourth quarter of our fiscal year, which includes the Christmas season. The amount of net sales and operating income generated during the fourth quarter depends upon the anticipated level of retail sales during the Christmas season, as well as general economic conditions and other factors beyond our control. In addition, the amount of net sales and operating income generated during the first quarter depends in part upon the actual level of retail sales during the Christmas season. There can be no assurance that such factors will not adversely affect our net sales and operating income during the first and fourth quarter of our fiscal year. Also, our gross profit margins are impacted by our sales mix. Both international and licensed watch sales generally provide gross margins in excess of our historical consolidated gross profit margin, while accessory products generally provide gross profit margins below our historical consolidated gross profit margin. There can be no assurance that future sales from our international businesses and licensed watch businesses will increase at a faster rate than our domestic accessory business.

***A number of our products are produced under licensing agreements, some of which will expire in the near-term future, that require minimum royalty commitments.***

A portion of our growth in sales and net income is, and is expected to continue to be, derived from the sales of products produced under licensing agreements with third parties. Sales of our licensed products amounted to 25% of our sales for fiscal year 2003. Under these license agreements, we generally have the right to produce, market and distribute certain products utilizing the brand names of other companies. Our material license agreements have various expiration dates between 2004 and 2009, with the DIESEL license expiring on December 31, 2004. We expect to sign a new license with DIESEL within the next few months. The failure by us to maintain or renew one or more of our existing material licensing agreements could adversely affect our revenues. In addition, we have experienced instances where minimum royalty commitments under these agreements exceeded revenues derived from related product sales. We can provide no assurance that we will not experience this again. We incurred royalty expense of approximately $29.8 million, $17.8 million and $11.2 million in fiscal years 2003, 2002 and 2001, respectively. We also have several agreements in effect at the end of fiscal year 2003 which expire on various dates from December 2004 through December 2009 that require us to pay royalties ranging from 7.0% to 20.0% of defined net sales.

***Our business may be harmed if we fail to protect our intellectual property.***

Our trademarks and other proprietary rights are important to our success and competitive position. We are devoted to the establishment and protection of our trademarks and proprietary rights on a worldwide basis. We cannot be certain that the actions we have taken will be adequate to prevent imitation of our products by others or to prevent others from seeking to prevent sales of our products as a violation of the trademarks or proprietary rights of others. In addition, we cannot be certain that others will not assert rights in, or ownership of, our trademarks and other proprietary rights or that we will be able to resolve these types of conflicts to our satisfaction. Because we sell our products internationally and are dependent on foreign manufacturing in Hong Kong and China, we are also dependent on the laws of foreign countries to protect our intellectual property. These laws may not protect proprietary rights to the same extent as the laws of the United States.

***Risks associated with foreign government regulations and U.S. trade policy may affect our foreign operations and sourcing.***

Our businesses are subject to risks generally associated with doing business abroad, such as foreign governmental regulation in the countries in which our manufacturing sources are located, primarily Hong Kong and other parts of China. While have not experienced any material issues with foreign governmental regulations that would impact our arrangements with our foreign manufacturing sources, we believe that this issue is of particular concern with regard to China due the less mature nature of the Chinese market economy and the historical involvement of the Chinese government in industry. If regulation were to render the conduct of business in a particular country undesirable or impracticable, or if our current foreign manufacturing sources were for any other reason to cease doing business with us, such a development could have a material adverse effect on our product sales and on our supply, manufacturing and distribution channels. Our business is also subject to the risks associated with the imposition of additional United States legislation and regulations relating to imports, including quotas, duties, tariffs or taxes, and other charges or restrictions on imports, which could adversely affect our operations and our ability to import products at current or increased levels. We cannot predict whether additional United States customs quotas, duties, tariffs, taxes or other charges or restrictions will be imposed upon the importation of our products in the future, or what effect such actions would have on our costs of operations.

***An increase in product returns could negatively impact our operating results.***

We recognize revenues as sales when merchandise is shipped and title transfers to the customer. We permit the return of damaged or defective products and accept limited amounts of product returns in certain other instances. Accordingly, we provide allowances for the estimated amounts of these returns at the time of revenue recognition based on historical experience. Any significant increase in product damages or defects and the resulting credit returns could have a material adverse impact on our operating results for the period or periods in which such returns materialize.

***Two principal stockholders own a significant amount of our outstanding common stock.***

Following this offering, Mr. Kosta Kartsotis, our President and CEO, will own 8,725,389 shares of our common stock and Mr. Tom Kartsotis, the Chairman of our Board of Directors, will own 12,786,585 shares of our common stock (or 12.37% and 18.13%, respectively, based on the number of shares outstanding as of May 11, 2004). As a result, they are in a position to significantly influence the outcome of elections of our directors, the adoption, amendment or repeal of our bylaws and any other actions requiring the vote or consent of our stockholders.

***Our organizational documents contain anti-takeover provisions that could discourage a proposal for a takeover of us.***

Our certificate of incorporation and bylaws, as well as the General Corporation Law of the State of Delaware, contain provisions that may have the effect of discouraging a proposal for a takeover of us. These include a provision in our certificate of incorporation authorizing the issuance of "blank check" preferred stock; the division of our Board of Directors into three classes to be elected on a staggered basis, one class each year; provisions in our bylaws establishing advance notice procedures with respect to certain stockholder proposals; and provisions requiring that action taken to remove a director without cause be approved either by an 80% vote of the Board of Directors or an 80% vote of the stockholders. Our bylaws may be amended by a vote of 80% of the Board of Directors, subject to repeal by a vote of 80% of the stockholders. In addition, Delaware law limits the ability of a Delaware corporation to engage in certain business combinations with interested stockholders. Finally, Messrs. Kartsotis have the ability, by virtue of their stock ownership, to significantly influence a vote regarding a change in control of us.

***Future sales of our common stock in the public market could adversely affect our stock price.***

The 8,725,389 shares beneficially owned by Mr. Kosta Kartsotis and the 12,786,585 shares beneficially owned by Mr. Tom Kartsotis following this offering may be sold in the open market in the future, subject to any volume restrictions and other limitations under the Securities Act of 1933 and Rule 144 thereunder. We may also decide to file a registration statement enabling Messrs. Kartsotis to sell additional shares. Although Messrs. Kartsotis have entered into "lock-up" agreements with the underwriters that prohibits them from selling shares during the 90 day period after the date of this prospectus, any subsequent sales by Messrs. Kartsotis of substantial amounts of our common stock in the open market, or the availability of their shares for sale, could adversely effect the price of our common stock. The market price of our common stock could decline as a result of sales of substantial amounts of our common stock in the public market, or the perception that those sales could occur. These sales or the possibility that they may occur also could make it more difficult for us to raise funds in any equity offering in the future at a time and price that we deem appropriate.

**Forward-looking statements**

This prospectus contains certain forward-looking statements that involve substantial risks and uncertainties, including, but not limited to, statements in the sections entitled "Management's discussion and analysis of financial condition and results of operations" and "Business." These forward-looking statements can generally be identified because the context of the statement includes words such as may, except, anticipate, intend, estimate, continue, believe, or other similar words. Similarly, statements that describe our future expectations, objectives and goals or contain projections of our future results of operations or financial condition are also forward-looking statements. Our future results, performance or achievements could differ materially from those expressed or implied in these forward-looking statements as a result of certain factors. Among the factors that could cause actual results to differ materially are: the effect of national and regional economic conditions, lowered levels of consumer spending resulting from a general economic downturn or generally reduced shopping activity caused by public safety concerns, the performance of our products within the prevailing retail environment, customer acceptance of both new designs and newly-introduced product lines, financial difficulties encountered by customers, the effects of vigorous competition in the markets in which we operate, the integration of the organizations and operations of any acquired businesses into our existing organization and operations, the termination or non-renewal of any acquired businesses into our existing organization and operations, the termination or non-renewal of material licenses, our foreign operations and manufacturing, changes in the costs of materials, labor and advertising, and our ability to secure and protect trademarks and other intellectual property rights. Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

**Use of proceeds**

We will not receive any proceeds from the sale of common stock by the selling stockholders.

**Price range of common stock**

Our common stock is traded on the Nasdaq National Market under the symbol "FOSL."

The following table sets forth reported last sale prices of our common stock for the periods indicated. Such prices have been adjusted to reflect a three-for-two stock split of our common stock effected as a fifty percent (50%) stock dividend paid on June 7, 2002. This data has also been adjusted to reflect the three-for-two stock split paid in the form of a stock dividend on April 8, 2004.

| | High | Low |
|---|---|---|
| Fiscal year beginning January 4, 2004: | | |
| First Quarter | $ 23.170 | $ 18.010 |
| Second Quarter (through May 10, 2004) | 25.840 | 22.650 |
| Fiscal year beginning January 5, 2003: | | |
| First Quarter | $ 14.360 | $ 10.633 |
| Second Quarter | 16.293 | 10.800 |
| Third Quarter | 19.333 | 15.833 |
| Fourth Quarter | 20.133 | 16.233 |
| Fiscal year beginning January 6, 2002: | | |
| First Quarter | $ 12.445 | $ 8.778 |
| Second Quarter | 15.827 | 11.685 |
| Third Quarter | 16.407 | 10.400 |
| Fourth Quarter | 15.080 | 9.993 |
| Fiscal year beginning December 31, 2000 | | |
| First Quarter | $ 9.000 | $ 6.111 |
| Second Quarter | 10.378 | 7.338 |
| Third Quarter | 9.911 | 6.271 |
| Fourth Quarter | 10.045 | 7.178 |

On May 11, 2004, the last reported sale price of our common stock was $24.03. As of March 15, 2004, there were 153 holders of record of our common stock.

**Dividend policy**

We expect that we will retain all available earnings generated by our operations for the development and growth of our business and do not anticipate paying any cash dividends in the foreseeable future. Any future determination as to dividend policy will be made at the discretion of our Board of Directors and will depend on a number of factors, including our future earnings, capital requirements, financial condition and future prospects and such other factors as the Board of Directors may deem relevant.

**Selected financial data**

The following information should be read in conjunction with our consolidated financial statements and related notes thereto incorporated by reference in this prospectus and "Management's discussion and analysis of financial condition and results of operations" included elsewhere in this prospectus. The selected statements of operations data for the 13 weeks ended April 3, 2004 and April 5, 2003 and the balance sheet data as of April 3, 2004 and April 5, 2003 are derived from our unaudited financial statements and are incorporated by reference in this prospectus. The selected statements of operations data for the fiscal years ended January 3, 2004, January 4, 2003 and January 5, 2002 and the balance sheet data as of January 3, 2004 and January 4, 2003 are derived from our audited financial statements and are incorporated by reference in this prospectus. The statements of operations data for the fiscal years ended December 30, 2000 and January 1, 2000 and the balance sheet data as of January 5, 2002, December 30, 2000 and January 1, 2000 are derived from audited financial statements that are neither included nor incorporated by reference in this prospectus.

| | 13 Weeks | | Fiscal year | | | | |
|---|---|---|---|---|---|---|---|
| | **2004** | **2003** | **2003** | **2002** | **2001** | **2000** | **1999** |
| **(dollars in thousands, except per share data)** | | | | | | | |
| **Statements of income and comprehensive income:** | | | | | | | |
| Net Sales | $ 199,395 | $ 169,767 | $ 781,175 | $ 663,338 | $ 545,541 | $ 504,285 | $ 418,762 |
| Gross Profit | 103,620 | 85,616 | 401,377 | 334,085 | 271,850 | 255,746 | 212,887 |
| Operating Income | 26,479 | 19,822 | 109,750 | 95,930 | 76,854 | 93,821 | 87,449 |
| Income before income taxes | 25,944 | 19,585 | 109,471 | 95,979 | 72,804 | 94,717 | 87,841 |
| Net income | 16,345 | 12,143 | 68,335 | 58,907 | 43,683(1) | 55,883 | 51,826 |
| Earnings per share:(2) | | | | | | | |
| Basic | 0.23 | 0.17 | 0.98 | 0.85 | 0.64(1) | 0.78 | 0.72 |
| Diluted | 0.22 | 0.17 | 0.93 | 0.81 | 0.62(1) | 0.76 | 0.69 |
| Weighted average common shares outstanding:(2) | | | | | | | |
| Basic | 70,007 | 69,618 | 69,818 | 68,990 | 67,877 | 71,301 | 71,775 |
| Diluted | 73,744 | 72,370 | 73,182 | 72,357 | 70,290 | 73,520 | 75,213 |
| **Balance sheet data:** | | | | | | | |
| Cash and equivalents(3) | $ 156,525 | $ 111,705 | $ 164,053 | $ 117,924 | $ 72,851 | $ 90,813 | $ 101,778 |
| Working capital | 338,046 | 248,859 | 313,561 | 241,177 | 163,280 | 169,792 | 155,198 |
| Total assets | 449,416 | 346,760 | 587,541 | 482,526 | 380,863 | 307,591 | 269,364 |
| Long-term debt | | | | | | | |
| Stockholders' equity | 440,465 | 349,757 | 423,426 | 340,541 | 264,023 | 220,699 | 191,197 |
| Return on average stockholders' equity(4) | 18.4% | 18.9% | 18.4% | 19.9% | 18.3% | 26.9% | 32.2% |

(1) Includes a $2.9 million one-time charge that reflects the write-off of the carrying value of our investment in SII Marketing International, Inc. as a result of our decision to terminate our equity participation in the joint venture relationship. Excluding this one-time charge, net income, basic earnings per share and diluted earnings per share were $46.5 million, $0.69 and $0.66, respectively.

(2) All share and per share price data has been adjusted to reflect three-for-two stock splits effected in the form of stock dividends paid on August 17, 1999 and June 7, 2002. This data has also been adjusted to reflect the three-for-two stock split declared on March 12, 2004 paid in the form of a stock dividend on April 8, 2004 to stockholders of record on March 26, 2004.

(3) Includes short-term marketable investments consisting of liquid investments with original maturities exceeding three months and mutual fund investments.

(4) The return on average stockholder's equity for the 13 week periods is based upon a trailing 12 month calculation.

## Management's discussion and analysis of financial condition and results of operations

*The following discussion and analysis should be read in conjunction with the "Selected financial data" and our financial statements and the related notes, which are incorporated by reference in this prospectus.*

We are a design, development, marketing and distribution company that specializes in consumer products predicated on fashion and value. The FOSSIL brand name was developed to convey a distinctive fashion, quality and value message and a brand image reminiscent of an earlier time that suggests a time of fun, fashion and humor. Since our inception in 1984, we have grown into a global watch company with a well-recognized branded portfolio delivered over an extensive distribution network. Our principle offerings include an extensive line of watches sold under our proprietary brands as well as licensed brands for some of the most prestigious companies in the world. We also offer complementary lines of small leather goods, belts, handbags and sunglasses under our proprietary FOSSIL and RELIC brands, jewelry under the FOSSIL and EMPORIO ARMANI brands and FOSSIL apparel. Our centralized infrastructure in design/development and production/sourcing allows us to leverage the strength of our branded watch portfolio over an extensive global distribution network.

Our products are sold primarily to department stores and specialty retail stores in over 90 countries worldwide through company-owned foreign sales subsidiaries and through a network of approximately 60 independent distributors. Our foreign operations include wholly or majority-owned subsidiaries in Australia, Canada, France, Germany, Hong Kong, Italy, Japan, the Netherlands, Singapore, Switzerland and the United Kingdom. In addition, our products are offered at company-owned retail locations, located in the United States and certain international markets, and authorized FOSSIL retail stores and kiosks located in several major airports, on cruise ships and in certain international markets. Our successful expansion of our product lines worldwide and leveraging of our infrastructure have contributed to our increasing net sales and operating profits.

### Significant accounting policies and estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires our management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to product returns, bad debts, and inventories. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which 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. Management believes the following critical accounting policies require the most significant estimates and judgments.

*Revenues.* Revenues are recognized at the point the goods leave our distribution center for the customer. Because the majority of our customers pay freight and do not have stated rights of inspection, title transfers at the point in time the goods leave our dock. We will accept limited returns and will request that a customer return a product if we feel the customer has an excess of any style that we have identified as being a poor performer for that customer or geographic location. While such returns have historically been within management's expectations and the provisions established, future return rates may differ from those experienced in the past. Any significant increase in product damages or defects and the resulting credit returns could have an adverse impact on the operating results for the period or periods in which such returns materialize.

*Accounts Receivable.* We perform ongoing credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined by the review of their current credit information. We continuously monitor collections and payments from our customers and maintain a provision for estimated credit losses based upon historical experience and any specific customer collection issues identified. While such credit losses have historically been within our expectations and the provisions established, future credit losses may differ from those experienced in the past.

*Inventories.* Inventories are stated at the lower of average cost, including any applicable duty and freight charges, or market. We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the average cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

*Asset Impairment.* We test for asset impairment whenever events or changes in circumstances indicate that the carrying value of an asset might not be recoverable from estimated future cash flows. We apply SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, in order to determine whether or not an asset is impaired. Our management evaluates the ongoing value of assets, primarily leasehold improvements and in-store fixturing, associated with our owned retail stores that have been open longer than one year. When undiscounted cash flows estimated to be generated through the operations of our owned retail stores are less than the carrying value of those assets, impairment losses are recorded in selling and distribution expenses. Should actual results or market conditions differ from those anticipated, additional losses may be recorded.

*Goodwill.* We adopted SFAS No. 142, Goodwill and Other Intangible Assets, on January 6, 2002. In accordance with SFAS No. 142, our management evaluates goodwill for impairment by comparing the fair value of the reporting unit to the book value. The fair value of our reporting units is estimated using discounted cash flow methodologies and market comparable information. Based on the analysis, if the implied fair value of each reporting unit exceeds the book value of the goodwill, no impairment loss is recognized. In the fourth quarter of fiscal 2003 and 2002, we performed the required annual impairment test and determined that no goodwill impairment existed.

*New Accounting Standards.* In May 2003, SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities" was issued that incorporates additional reporting standards for derivative instruments. While we follow FASB No. 133, the amendment as issued under SFAS No. 149 will not impact our consolidated financial statements.

**First quarter 2004 highlights**

- Sales generated from our other international segment, which includes our subsidiaries in the Far East and Canada and our export business from the U.S., increased approximately 56% during the first quarter with growth in all geographic areas and all brands.

- We operated 120 retail locations (54 outlet and 66 full-price) at the end of the first quarter, compared to 104 stores (47 outlet and 57 full-price) at the end of the prior year quarter. This retail store expansion and 19.5% same store sales growth generated sales increases of 31% during the first quarter.

- Sales of licensed brand watches increased by 33.8% during the first quarter and represent approximately 27% of our consolidated net sales.

- Sales generated from our RELIC watch brand increased approximately 60% during the first quarter as a result of exciting new styles introduced and new customers.

- We launched our Wrist.net watches to approximately 1,000 department stores and electronic retailers.

Subsequent to the end of the first quarter, we announced the acquisition of Michele Watches and the signing of a licensing agreement for MICHAEL Michael Kors® watches.

**2003 highlights**

During 2003, we launched the BURBERRY line of Swiss-made watches globally. We believe BURBERRY watches will expand our existing relationships with our international customer base and add specialty watch and jewelry store distribution in the U.S.

EMPORIO ARMANI jewelry, initially launched in the fourth quarter of 2002, was further rolled-out globally. Combined with the existing EMPORIO ARMANI watch business, this business will assist us in expanding our license relationship with the Giorgio Armani group while providing the opportunity to extend the global presence of our product assortment under this brand.

With the addition of BURBERRY watches and solid growth in EMPORIO ARMANI, DKNY and DIESEL watches, licensed watch sales increased to 25% of consolidated sales in 2003 compared to 21% in 2002. The retail price points of these aspirational brands are generally higher than the related retail prices of our proprietary brands allowing us to experience higher sales and gross profit margins per unit.

In January, we completed the consolidation of our North American distribution/warehouse operations into our state-of-the-art 500,000 square foot distribution center located in Dallas.

In July, we put into service a new enterprise resource planning system, SAP, for our North American operations. We anticipate converting all of our subsidiaries' systems to SAP over the next several years. Implementation of SAP in Germany commenced during the fourth quarter and we expect the European phase of our global implementation to be complete by the end of 2005 or early 2006.

In September, we moved into our new 100,000 square foot European distribution facility located in Germany. We believe consolidation of existing distribution facilities in France, Italy, Switzerland and the UK into our new European distribution facility will be completed over the next several years.

Our operating margin for 2003 was 14.1% and our goal is to reach 17% over the next few years. During the second half of 2003, our sales growth and increasing gross profit margin resulted in increased operating margins over the comparable prior year period. We believe this to be a significant achievement given our continued investment in new business initiatives, including technology products, Swiss watches and jewelry, as well as infrastructure additions, including new distribution facilities and SAP, to support our future growth prospects.

During 2003, our retail stores experienced same-store sales comparisons in excess of 10%. This sales growth, combined with higher gross profit margins and lower operating expenses as a percentage of sales, resulted in operating income growth within the retail store segment of approximately $11 million in 2003 over 2002.

**Results of operations**

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

| | 13 weeks | | | Fiscal Year | | | | |
|---|---|---|---|---|---|---|---|---|
| | **April 3, 2004** | **April 5, 2003** | **Percentage change from April 5, 2003** | **2003** | **Percentage change from 2002** | **2002** | **Percentage change from 2001** | **2001** |
| Net sales | 100.0% | 100.0% | 17.5% | 100.0% | 17.8% | 100.0% | 21.6% | 100.0% |
| Cost of sales | 48.0 | 49.6 | 13.8 | 48.6 | 15.4 | 49.6 | 20.3 | 50.2 |
| Gross profit | 52.0 | 50.4 | 21.0 | 51.4 | 20.1 | 50.4 | 22.9 | 49.8 |
| Operating expenses | 38.7 | 38.8 | | 37.3 | 22.5 | 35.9 | 22.1 | 35.7 |
| Operating income | 13.3 | 11.7 | 33.6 | 14.1 | 14.4 | 14.5 | 24.8 | 14.1 |
| Interest expense | 0.0 | 0.0 | (25.0) | | (42.1) | | (66.4) | 0.1 |
| Other (expense) income net | (0.3) | (0.1) | (127.5) | | (239.1) | | 104.2 | (0.7) |
| Income before income taxes | 13.0 | 11.6 | 32.5 | 14.1 | 14.1 | 14.5 | 31.8 | 13.3 |
| Provision for income taxes | 4.8 | 4.4 | 29.0 | 5.3 | 11.0 | 5.6 | 27.3 | 5.3 |
| Net income | 8.2% | 7.2% | 34.6% | 8.8% | 16.0% | 8.9% | 34.9% | 8.0% |

The following table sets forth certain components of our consolidated net sales and the percentage relationship of the components to consolidated net sales for the periods and fiscal year indicated:

| | 13 weeks | | | | Fiscal Year | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Amounts in millions** | | **Percentage of total** | | **Amounts in millions** | | | **Percentage of total** | | |
| | **April 3, 2004** | **April 5, 2003** | **April 3, 2004** | **April 5, 2003** | **2003** | **2002** | **2001** | **2003** | **2002** | **2001** |
| International: | | | | | | | | | | |
| Europe | $ 66.8 | $ 55.5 | 33% | 33% | $ 258.1 | $ 189.4 | $ 130.3 | 33.1% | 28.6% | 23.9% |
| Other | 27.3 | 17.5 | 14 | 10 | 82.0 | 63.6 | 56.1 | 10.5 | 9.6 | 10.3 |
| Total international | 94.1 | 73.0 | 47 | 43 | 340.1 | 253.0 | 186.4 | 43.6 | 38.2 | 34.2 |
| Domestic: | | | | | | | | | | |
| Watch products | 44.5 | 42.8 | 22 | 25 | 205.7 | 200.9 | 180.6 | 26.3 | 30.3 | 33.1 |
| Other products | 39.7 | 37.9 | 20 | 22 | 131.3 | 126.3 | 110.3 | 16.8 | 19.0 | 20.2 |
| Total domestic | 84.2 | 80.7 | 42 | 47 | 337.0 | 327.2 | 290.9 | 43.1 | 49.3 | 53.3 |
| Retail worldwide | 21.1 | 16.1 | 11 | 10 | 104.1 | 83.1 | 68.2 | 13.3 | 12.5 | 12.5 |
| Total net sales | $ 199.4 | $ 169.8 | 100% | 100% | $ 781.2 | $ 663.3 | $ 545.5 | 100.0% | 100.0% | 100.0% |

**13 weeks ended April 3, 2004 compared to 13 weeks ended April 5, 2003**

*Net sales.* The following table is intended to illustrate by factor the total of the year-over-year percentage change in sales by segment and on a consolidated basis:

**Analysis of Percentage Change in Sales Versus Prior Year Quarter Attributable to Changes in the Following Factors**

| | Exchange Rates | Organic Growth | Total Change |
|---|---|---|---|
| Europe | 15.8% | 4.6% | 20.4% |
| Other international | 4.8% | 50.8% | 55.6% |
| Domestic wholesale | 0.0% | 4.3% | 4.3% |
| Retail worldwide | 2.2% | 29.1% | 31.3% |
| Total | 5.9% | 11.5% | 17.4% |

*International Net Sales.* Excluding the impact on sales growth attributable to foreign currency rate changes as noted in the above table, European sales growth was driven principally by sales volume increases in FOSSIL, DIESEL and DKNY watches. Growth from other international sales, which include our Canada and Far East distribution businesses and export sales from the U.S., was led primarily by sales volume increases in FOSSIL, BURBERRY, DKNY and DIESEL watch businesses. We believe we maintain a competitive advantage as a result of our long-term relationships and strength of our business with retailers throughout the international marketplace. We further believe our impressive portfolio of global watch brands and our ability to acquire additional brands position us for further penetration internationally as we continue to take shelf space from lesser known local and regional brands. We believe these brands do not have the marketing strength, distribution network or the global brand recognition in comparison to the brands included in our watch portfolio.

*Domestic Net Sales.* Domestic watch sales increased 4.2% primarily as a result of sales volume increases in sales of RELIC and licensed watches partially offset by a 5.2% decrease in FOSSIL watches. The decrease in FOSSIL watches was primarily due to the strong results of the brand in the fourth quarter of 2003 in which we experienced sales volume growth of approximately 20%. We believe the increase in RELIC watch sales is due to the introduction of new styles, including those with enhanced dial movements, and additional customers added in late 2003. Increased sales in the licensed watch category were primarily related to BURBERRY watches. Management believes it can gain additional market share for FOSSIL and its other watch brands in the U.S. market by expanding into both a greater number of locations with our existing retailers as well as adding additional retailers for certain brands that we believe are under-penetrated. We believe this can be accomplished by utilizing the talent of our broad-based design group and exploiting the speed of our supply chain that we believe allows for a quicker response to changes in fashion trends than its competitors. Domestic sales of our accessory and sunglass businesses rose 4.7% compared to the prior year quarter with particular strength in FOSSIL eyewear and EMPORIO ARMANI jewelry. In total, domestic wholesale sales rose by 4.3%.

*Stores Worldwide Net Sales.* Sales from company-owned retail stores worldwide increased 31.3% during the first quarter as a result of a 14.9% increase in the average number of stores opened during the quarter and comparable store sales gains of 19.6%. We believe our double-digit comparable store growth during the first quarter was attributable to better in-store merchandising and visual presentation and lower quantities of discounted merchandise available in comparison to the prior year quarter that resulted in higher average selling prices during the first quarter.

*Gross Profit.* Gross profit margin expanded by 160 basis points to 52.0% in the first quarter compared to 50.4% in the prior year period. The increase in gross profit margin is mainly attributable to expanded gross profit margin in our international businesses, as a result of stronger foreign currencies, and increased gross profit margins from our company-owned retail stores, primarily related to our outlet stores. Gross profit margin was also favorably impacted by a higher mix of sales related to our international businesses and company-owned retail stores as a percentage of total sales. Sales from these two segments of our business generally produce higher gross profit margins than our historical consolidated gross profit margin. Gross profit margin from our domestic wholesale businesses remained relatively unchanged from the prior year period.

*Operating Expenses.* Operating expenses, as a percentage of net sales, improved by 10 basis points to 38.7% in the first quarter compared to 38.8% in the comparable prior year period. Included in first quarter operating expenses is approximately $3.5 million in additional costs related to the translation impact of stronger foreign currencies into U.S. dollars. Excluding the currency and sales volume increase impact, operating expense increases were mainly driven by increases in (i) personnel and other related costs associated with our new business initiatives, (ii) depreciation and amortization expense and (iii) professional fees. Costs associated with new business initiatives, which primarily relate to our Swiss watch and mass market product offerings, increased by $2.3 million during the first quarter. Depreciation and amortization expense increases of $1.6 million are related to our SAP software implementation, as well as other capital additions made in 2003. Increases in professional fees of $1.7 million were primarily related to consulting cost associated with our U.S. based SAP system, that was implemented in July 2003, and accounting and legal fees incurred in connection with our European reorganization project. Advertising expense decreased approximately $800,000 in the first quarter as a result of certain new product launch costs incurred during the prior year quarter.

*Operating Income.* Gross profit increased by approximately $18 million, or 21%, during the first quarter as a result of strong sales gains combined with improvements in gross profit margin. This increase in gross profit more than offset increased operating expenses, resulting in an increase in our first quarter operating profit margin of 160 basis points to 13.3% of net sales compared to 11.7% of net sales in 2003. Operating income for the first quarter included approximately $3 million of additional income as a result of the effects of stronger foreign currencies.

*Other Income (Expense) net.* Other income (expense) primarily reflects interest income from cash investments, royalty income, minority interest expense of our majority-owned subsidiaries and equity in the earnings (losses) of its non-consolidated joint venture. During the first quarter, other income (expense) decreased unfavorably by approximately $300,000 primarily as a result of increased minority interest expense partially offset by increased interest income due to higher levels of invested cash balances maintained during the first quarter.

*Provision For Income Taxes.* Our effective income tax rate decreased to 37% during the first quarter, compared to 38% in the prior year comparable period. This decrease was primarily related to a higher percentage of income generated from countries whose statutory income tax rates are lower than our historical average income tax rate.

*2004 Net Sales and Earnings Estimates.* We believe second quarter 2004 diluted earnings per share will approximate $0.17, which reflects current First Call Consensus estimates, compared to diluted earnings per share of $0.14 in the second quarter of 2003. For fiscal 2004, we currently estimate diluted earnings per share in a range of $1.17 to $1.20 compared to our previous guidance range of $1.11 to $1.14. This increase is primarily related to our better than expected first quarter results and planned accretion related to the acquisition of Michele Watches. The low-end of our current guidance range represents growth of approximately 26% over fiscal 2003 actual diluted earnings per share of $0.93. The current First Call Consensus earnings per share estimate for fiscal 2004 is $1.13. We estimate fiscal 2004 sales growth in the 20% range.

**Fiscal 2003 compared to fiscal 2002**

*Net sales.* The following table is intended to illustrate by factor the total year-over-year percentage change in sales by segment and on a consolidated basis:

**Analysis of Percentage Change in Sales Versus Prior Year Attributable to Changes in the Following Factors**

| | Exchange Rates | Acquisitions | Organic Growth | Total Change |
|---|---|---|---|---|
| Europe | 19% | 2% | 15% | 36% |
| Other international | 5 | 9 | 15 | 29 |
| Domestic wholesale | | | 3 | 3 |
| Retail worldwide | 1 | 5 | 19 | 25 |
| Total | 6% | 2% | 10% | 18% |

*International Net Sales.* Excluding the impact on sales growth attributable to foreign currency rate changes as noted in the above table, European sales growth was driven by sales volume increases in FOSSIL, DIESEL and DKNY watches and FOSSIL and EMPORIO ARMANI jewelry. Growth from other international sales, which include our Canada and Far East distribution businesses and export sales from the U.S., was led by sales volume increases in FOSSIL, EMPORIO ARMANI and DIESEL watch businesses. We believe we maintain a competitive advantage as a result of our long-term relationships and strength of our business with our retailers throughout the international marketplace. We further believe our impressive portfolio of global watch brands and our ability to acquire additional brands position us for further penetration internationally as we continue to take shelf space from lesser known local and regional brands. We believe these brands do not have the marketing strength, distribution network or the global brand recognition in comparison to the brands included in our watch portfolio. Additionally, we anticipate that the recent additions of Swiss-made BURBERRY and ZODIAC watches and EMPORIO ARMANI jewelry will further advance our product offering and allow for long-term leverage of our existing distribution infrastructure outside the U.S. further strengthening our competitive advantage. Our management believes our international businesses will continue to contribute significant double-digit sales increases in 2004, assuming the Euro foreign currency rate remains near the 1.25 to 1.0 level relative to the U.S. dollar.

*Domestic Net Sales.* Domestic watch sales increased 2.4% on sales volume increases primarily as a result of a 5.5% increase in sales of FOSSIL watches and a 17.3% increase in sales of licensed brand watches. The re-emergence of leather strap watches as a popular fashion item and the increased market penetration of Fossil watches that have motion taking place on the dial were the primary factors behind increases in FOSSIL watch sales. These sales gains were partially offset by an 18% decrease in sales of RELIC watches and a 98% decrease in sales of the EDDIE BAUER private label watch line. During 2003, we chose not to renew our watch license for the EDDIE BAUER brand name, due primarily to the financial difficulties experienced by EDDIE BAUER'S parent company. We believe that the decline in sales of RELIC watches is primarily due to increased competition from less expensive fashion watches. Our management believes it can gain additional market share for FOSSIL and our other watch brands in the U.S. market by expanding into both a greater number of locations with our existing retailers as well as adding additional retailers for certain brands that we believe are under-penetrated by utilizing the talent of our broad-based design group and exploiting the speed of our supply chain that allows for quicker response to changes in fashion trends than our competitors. Domestic sales of our accessory and sunglass businesses rose 4.0% resulting from a 34%, 7% and 79% increase in RELIC accessories, FOSSIL men's leather and FOSSIL sunglasses, respectively. Excluding RELIC eyewear, which experienced a 57% decrease in sales volume in 2003 due to the loss of a sizeable portion of a significant customer's business, domestic sales of our accessory and sunglass businesses increased 9.0%. FOSSIL watches and accessories continue to be a leading supplier to U.S. department and specialty retail stores. Moreover, management believes Swiss-made BURBERY and ZODIAC watches and EMPORIO ARMANI jewelry will allow us to expand into additional distribution channels in the U.S., primarily specialty watch and jewelry stores during 2004 and beyond. Management believes sales growth for our domestic wholesale businesses to be in the mid to high single digit range for 2004.

*Company-Owned Retail Stores Net Sales.* Sales from company-owned retail stores worldwide increased 25.3% during the year as a result of a 14.4% increase in the average number of stores opened during the year and comparable store sales gains of 10.6%. Our management believes our double-digit comparable store growth during the year was attributable to better in-store merchandising and visual presentation and lower quantities of discounted merchandise available in comparison to the prior year, that resulted in higher average selling prices during 2003. We operated 119 stores at the end of the year, consisting of 53 outlet, 26 accessory and 18 jeanswear stores in the United States and 22 accessory stores located outside the United States. This compares to 104 stores at the end of the prior year, 47 outlet, 23 accessory and 18 jeanswear in the United States and 16 accessory stores located outside the United States. We opened 17 new stores during the year, including six stores acquired in Europe, and closed two stores. With the addition of an outlet opened in early 2004, we currently operate 120 stores, consisting of 54 outlet, 26 accessory and 18 jeanswear stores in the United States and 22 accessory stores located outside the United States. Our management expects that 12 to 16 new stores will be opened in 2004 with at least one-half of these new store openings planned to be outlet concepts. Based upon planned new door openings and continued positive comparable store sales growth, management believes retail stores net sales growth will exceed 15% in 2004. A store is included in comparable store sales in the thirteenth month of operation. Stores that experience a gross square footage increase of 10% or more due to an expansion and/or relocation are removed from the comparable store sales base, but are included in total sales. These stores are returned to the comparable store sales base in the thirteenth month following the expansion and/or relocation.

*Gross Profit.* Gross profit margin increased to 51.4% compared to 50.4% in the prior year, or 100 basis points. This margin expansion can be attributed primarily to (i) increased sales, as a percentage of total sales, from our international businesses, company-owned retail stores and licensed watch products; and (ii) higher international gross profit margin due to stronger foreign currencies, primarily the Euro. Sales from our international businesses, company-owned retail stores and licensed products generally provide gross profit margins in excess of our historical consolidated gross profit margin. Gross profit margins generated from our international businesses are historically higher than those experienced in the U.S., mainly due to higher average wholesale prices charged for watch products internationally and the general absence of lower margin accessory businesses offered outside the U.S. Partially offsetting these gross profit margin increases were increased sales, as a percentage of total sales, from RELIC accessory products that generally provide gross profit margin below our historical consolidated gross profit margin. Our management believes 2004 gross profit margin will be favorably impacted because sales from our international businesses and company-owned retail stores are forecasted to increase at a faster rate than our total sales. Additionally, assuming the Euro foreign currency rate remains near the 1.25 to 1.0 level relative to the U.S. dollar, we believe gross profit margin for 2004 could increase 50 to 75 basis points.

*Operating Expenses.* Operating expenses increased approximately $53 million during 2003 and, as a percentage of net sales, increased to 37.3% during 2003 compared to 35.9% for the prior year. Included in 2003 operating expenses is approximately $13 million in additional costs related to the translation impact of stronger foreign currencies into U.S. dollars and approximately $7 million related to operating expenses of businesses acquired in 2002. The remaining $33 million increase in operating expenses during 2003 primarily reflects (i) $9.4 million in additional personnel and other costs associated with new business initiatives primarily related to our Swiss watch, EMPORIO ARMANI jewelry and technology-enhanced watch businesses for which there have been minimal revenue contributions to date, (ii) advertising costs, (iii) depreciation and amortization expense and (iv) additional costs to support sales volume growth. For the year, total advertising expense increased $11.0 million to 7.1% of net sales compared to 6.7% of net sales in 2002. Depreciation and amortization expense increased $4.8 million due to completion of the first phase of our SAP global software implementation in July 2003 as well as other capital additions made during 2003. Our management anticipates 2004 operating expenses, as a percentage of net sales, to decrease slightly from the levels experienced in 2003, assuming increased revenue contributions from the new business initiatives and non-recurrence of certain new product launch costs incurred during 2003. Because our sales are more heavily weighted toward the second half of the year, management expects operating expenses as a percentage of sales to be equal to or slightly greater than the prior year during the first six months of 2004 and slightly less than the prior year in the second six months of the year.

*Operating Income.* Increased operating expenses, as a percentage of net sales, were partially offset by improved gross profit margins resulting in operating profit margin of 14.1% of net sales compared to 14.5% of net sales in 2002. Operating income for the year included approximately $15 million of additional income as a result of the effects of stronger foreign currencies. Our management believes operating margin for 2004 could expand by 50 to 100 basis points, based on assumptions discussed above. Operating profit margin during the first half of 2004 could be slightly below this range, while operating margin in the second half of the year could approach, or slightly exceed, the high end of the range.

*Other Income (Expense).* Other income (expense) primarily reflects interest income from cash investments, royalty income, foreign currency transaction gains (losses), minority interest expense of our majority-owned consolidated subsidiaries and equity in the earnings of our non-consolidated joint venture. During 2003, other income (expense) decreased unfavorably by approximately $300,000. The decrease was primarily a result of increased minority interest expense and legal expenses related to enforcing our intellectual property rights offset by foreign currency transaction gains and increased interest income due to higher levels of invested cash balances maintained during 2003.

*Income Taxes.* Our effective income tax rate decreased to 37.6% during 2003 compared to 38.6% in the prior year. This decrease was primarily related to a higher mix of income generated from countries whose statutory income tax rates are lower than our historical average income tax rate. Our management believes this trend in our mix of income will continue, and as a result, expects our income tax rate to decrease slightly in 2004.

**Fiscal 2002 compared to fiscal 2001**

*Net Sales.* Net sales increased 22% for the year (19% excluding currency gains). This increase was led by strong sales volume growth in our international businesses, primarily from Europe which experienced a 45% increase (36% excluding currency gains). We believe our strategy of utilizing our impressive portfolio of watch brands continues to position us for further market penetration in Europe and the Far East. Also, we believe the addition of Swiss-made BURBERRY and ZODIAC watches and EMPORIO ARMANI jewelry will further advance our product offerings and allow for long-term leverage of our existing distribution infrastructure inside and outside the U.S. Businesses acquired in Switzerland, Canada and Japan contributed approximately $6.7 million to international sales. In the U.S., sales from our domestic wholesale businesses grew 12% as a result of further expansion of RELIC accessories, significant growth in licensed watch sales and solid growth in FOSSIL watches and accessories. Market expansion of RELIC handbags, small leather goods and sunglasses in the national department store channel accelerated beyond the launch of these product categories in 2001. Licensed watch sales growth in 2002 benefited from the launch of the COLUMBIA brand and further market penetration in DIESEL, EMPORIO ARMANI and DKNY. FOSSIL watches grew market share in the U.S. during 2002 and further expanded its leading fashion watch position in department and selected specialty stores.

*Gross Profit.* Gross profit margin increased to 50.4% compared to 49.8% in the prior year. This increase is attributed to increased sales mix from our international businesses and licensed watches as a percentage of total sales. International sales and licensed watch sales grew to approximately 38% and 21% of total sales during 2002, respectively, as compared to 34% and 17.5% during 2001, respectively. Both international and licensed watch sales generally provide gross margins in excess of our historical consolidated gross profit margin. Additionally, gross profit margin was favorably impacted from a lower sales mix of accessory products that generally provide gross profit margins below our historical consolidated gross profit margin. A stronger Euro during 2002 compared to the prior year slightly benefited gross profit margin.

*Operating Expenses.* Operating expenses, as a percentage of net sales, increased to 35.9% compared to 35.7% for the prior year. The $43 million increase in operating expenses primarily reflects increased variable costs to support sales growth, as well as higher distribution costs relating to our new distribution facility, increased payroll cost, increased advertising expenditures, operating expenses related to acquired businesses and higher costs in Europe due to the effects of a stronger Euro. The increase in payroll and advertising costs is primarily associated with new business initiatives, including Swiss-made watches, jewelry and new technology products.

*Operating Income.* Increased sales and improved gross profit margin more than offset increases in operating expenses for the year. As a result, our operating profit margin increased to 14.5% from 14.1% in the prior year.

*Other Income (Expense).* Other income (expense) primarily reflects interest income from cash investments, royalty income, minority interests in the earnings (loss) of our majority-owned subsidiaries and equity in the earnings (losses) of our non-consolidated joint venture. During 2002, other income (expense) decreased unfavorably by approximately $900,000 primarily as a result of reduced interest income due to lower yields on invested cash balances and the effects of a $500,000 legal settlement received by us in the prior year.

*Income Taxes.* Our effective income tax rate decreased to 38.6% during 2002 compared to 40% in the prior year. This decrease was primarily related to a higher mix of income generated from countries whose statutory income tax rates are lower than our historical average income tax rate.

**Effects of inflation**

Our management does not believe that inflation has had a material impact on results of operations for the periods presented. Substantial increases in costs, however, could have an impact on us and the industry. Management believes that, to the extent inflation affects its costs in the future, we could generally offset inflation by increasing prices if competitive conditions permit.

**Liquidity and capital resources**

Our general business operations historically have not required substantial cash needs during the first several months of our fiscal year. Generally, starting in the second quarter, our cash needs begin to increase, typically reaching its peak in the September-November time frame. Our cash holdings and short-term marketable securities as of the end of the first quarter increased to $162.6 million in comparison to $117.1 million at the end of the prior year quarter. However, cash holdings and short-term marketable securities decreased slightly compared to the $164.1 million at the end of the prior year. This decrease is primarily the result of $5.3 million of net cash used in investing activities and $2.6 million related to exchange rate changes partially offset by $5.5 million of cash generated from operating and $800,000 from financing activities. Net cash used in investing activity was mainly related to $4.7 million of capital additions. Cash flows generated from operating activities were primarily related to increased net income partially offset by increases in working capital, while cash flows generated from financing activities were comprised of $4.4 million of proceeds from the exercise of stock options partially offset by repurchases of common stock and distributions of minority interest earnings.

Accounts receivable increased to $112.6 million at the end of the first quarter compared to $80.5 million at the end of the prior year quarter. Day's sales outstanding increased to 51 days for the first quarter compared to 43 days in the prior year quarter. This increase is attributable to an increase in our average collection cycle and a decrease in the relative percentage of return allowances in our net accounts receivable balance. The collection cycle has increased as a result of a larger percentage of international sales that historically have longer collection periods than those experienced in our U.S. business. Adding to the delay in collection of our receivables was an increase in our domestic billing cycle in the U.S. caused by some inconsistencies in our SAP generated electronic invoices. Inventory at quarter-end was $142.3 million, an increase of 16.4% compared to prior year inventory of $122.2 million.

At the end of the first quarter, we had working capital of $338 million compared to working capital of $248.9 million at the end of the prior quarter. We had approximately $2.8 million of outstanding borrowings at the end of the quarter. These borrowings are under a short-term facility in Japan bearing interest at the Euroyen rate (approximately 0.7% at quarter-end), due October 2004. No borrowings under this credit facility were incurred during 2003. Our management believes that cash flow from operations combined with existing cash on hand and amounts available under our credit facility will be sufficient to satisfy the cash requirements of our working capital needs for at least the next 18 months.

During 2004, we anticipate capital expenditures in the range of $20 $25 million to cover principally additional computer software implementation cost and hardware purchases, leasehold and owned facility improvements and warehouse equipment purchases. In addition, it is our intent to continue our stock repurchase program to partially offset the dilutive effect of stock options granted. This program could add an additional $15 $20 million to our capital requirements in 2004. Management believes that cash flow from operations combined with existing cash on hand will be sufficient to fund our capital needs during 2004. We also have access to approximately $40 million in undrawn credit facilities should additional funds be required.

**Contractual obligations and off-balance sheet arrangements**

The following table presents, as of January 3, 2004, a summary of our significant cash contractual obligations by payment date. Further discussion of the nature of each obligation is included in note 10 to our consolidated financial statements.

| (in thousands) | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
|---|---|---|---|---|---|
| **Contractual Obligations** | | | | | |
| Short-term debt(1) | 2,805 | 2,805 | | | |
| Minimum royalty payments(2) | 117,835 | 22,092 | 45,613 | 43,302 | 6,828 |
| Future minimum rental commitments | 106,476 | 18,760 | 32,719 | 26,382 | 28,615 |
| Purchase obligations(3) | 8,865 | 8,865 | | | |
| Total contractual cash obligations | 227,116 | 43,657 | 78,332 | 69,684 | 35,443 |

(1) Consists of short-term credit borrowings in Japan due October 2004.

(2) Consists of primarily exclusive licenses to manufacture watches under trademarks not owned by us. Also includes amounts owed pursuant to various license and design service agreements under which we are obligated to pay the licensors a percentage of our net sales of these licenses products, subject to minimum scheduled royalty, design and advertising payments.

(3) Consists of outstanding letters of credit, which primarily represent inventory purchase commitments that typically mature in one to eight months.

A schedule of significant commitments under our license agreements is also set forth under note 10 of our consolidated financial statements. We have no consolidated off-balance sheet arrangements or material purchase obligations.

**Quantitative and qualitative disclosures about market risk**

As a multinational enterprise, we are exposed to changes in foreign currency exchange rates. Our most significant foreign currency risk relates to the Euro and the British Pound as compared to the U.S. dollar. Due to our vertical nature whereby a significant portion of goods are sourced from our owned facilities, the foreign currency risks relate primarily to the necessary current settlement of intercompany inventory transactions. We employ a variety of practices to manage this market risk, including our operating and financing activities and, where deemed appropriate, the use of foreign currency forward contracts. The use of these instruments allows management 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 manage foreign currency transactional exposure in 2003 and management does not anticipate any significant changes in such exposures or in the strategies we employs to manage such exposure in the near future.

At year-end we had outstanding foreign exchange contracts to sell (i) 34.3 million Euro for approximately $40.1 million, expiring through December 2004, and (ii) approximately 3.5 million British Pounds for approximately $5.9 million, expiring through April 2004. If we were to settle our Euro and British Pound based contracts at fiscal year-end 2003, the net result would be a loss of approximately $2.2 million, net of taxes. Exclusive of these outstanding foreign exchange contracts or other operating or financing activities that may be employed by us, a measurement of the unfavorable impact of a 10 percent change in the Euro and British Pound as compared to the U.S. dollar would have on our operating profits and stockholder's equity is presented in the following paragraph.

At fiscal year-end 2003, a 10 percent unfavorable change in the U.S. dollar against the Euro and British Pound involving balance sheet transactional exposures would have resulted in a net pretax loss of less than $100,000. The translation of the balance sheets of our European and United Kingdom-based operations from their local currencies into U.S. dollars is also sensitive to changes in foreign currency exchange rates. At fiscal year-end 2003, a 10 percent unfavorable change in the exchange rate of the U.S. dollar against the Euro and British Pound would have reduced stockholder's equity by approximately $9.0 million. In the view of management, the risks associated with exchange rate changes in other currencies we have exposure to are not material and these hypothetical losses resulting from these assumed changes in foreign currency exchange rates are not material to our consolidated financial position, results of operation or cash flows.

**Selected quarterly financial data**

The table below sets forth selected quarterly financial information. The information is derived from our unaudited consolidated financial statements and includes, in the opinion of management, all normal and recurring adjustments that management considers necessary for a fair statement of results for such periods. The operating results for any quarter are not necessarily indicative of results for any future period.

| Fiscal Year 2004 | 1st Qtr |
|---|---|
| (dollars in thousands, except per share data) | |
| Net sales | $ 199,395 |
| Gross profit | 103,620 |
| Operating expenses | 77,141 |
| Operating income | 26,479 |
| Income before income taxes | 25,944 |
| Provision for income taxes | 9,599 |
| Net income | 16,345 |
| Earnings per share: | |
| Basic | 0.23 |
| Diluted | 0.22 |
| Gross profit as a percentage of net sales | 52.0% |
| Operating expenses as a percentage of net sales | 38.7% |
| Operating income as a percentage of net sales | 13.3% |

| Fiscal Year 2003 | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr |
|---|---|---|---|---|
| (dollars in thousands, except per share data) | | | | |
| Net sales | $ 169,767 | $ 159,593 | $ 192,616 | $ 259,199 |
| Gross profit | 85,616 | 81,868 | 96,976 | 136,917 |
| Operating expenses | 65,794 | 65,670 | 69,592 | 90,571 |
| Operating income | 19,822 | 16,198 | 27,384 | 46,346 |
| Income before income taxes | 19,585 | 16,706 | 27,183 | 45,997 |
| Provision for income taxes | 7,442 | 6,317 | 10,383 | 16,994 |
| Net income | 12,143 | 10,389 | 16,800 | 29,003 |
| Earnings per share: | | | | |
| Basic | 0.17 | 0.15 | 0.24 | 0.41 |
| Diluted | 0.17 | 0.14 | 0.23 | 0.39 |
| Gross profit as a percentage of net sales | 50.4% | 51.3% | 50.3% | 52.8% |
| Operating expenses as a percentage of net sales | 38.8% | 41.1% | 36.1% | 34.9% |
| Operating income as a percentage of net sales | 11.7% | 10.1% | 14.2% | 17.9% |

| Fiscal Year 2002 | 1st Qtr | 2nd Qtr | 3rd Qtr | 4th Qtr |
|---|---|---|---|---|
| (dollars in thousands, except per share data) | | | | |
| Net sales | $ 143,680 | $ 142,460 | $ 164,821 | $ 212,377 |
| Gross profit | 71,492 | 71,475 | 81,579 | 109,539 |
| Operating expenses | 52,229 | 55,306 | 58,419 | 72,201 |
| Operating income | 19,263 | 16,169 | 23,160 | 37,338 |
| Income before income taxes | 19,367 | 15,962 | 23,112 | 37,538 |
| Provision for income taxes | 7,552 | 6,224 | 9,015 | 14,281 |
| Net income | 11,815 | 9,738 | 14,097 | 23,257 |
| Earnings per share: | | | | |
| Basic | 0.17 | 0.14 | 0.21 | 0.33 |
| Diluted | 0.17 | 0.13 | 0.19 | 0.32 |
| Gross profit as a percentage of net sales | 49.8% | 50.2% | 49.5% | 51.6% |
| Operating expenses as a percentage of net sales | 36.4% | 38.8% | 35.4% | 34.0% |
| Operating income as a percentage of net sales | 13.4% | 11.3% | 14.1% | 17.6% |

While the majority of our products are not seasonal in nature, a significant portion of our net sales and operating income is generally derived in the second half of the year. Our fourth quarter, which includes the Christmas season, generated in excess of 40% of our annual operating income for 2003. The amount of net sales and operating income generated during the first quarter is affected by the levels of inventory held by retailers at the end of the Christmas season, as well as general economic conditions and other factors beyond our control. In general, lower levels of inventory held by retailers at the end of the Christmas season may have a positive impact on our net sales and operating income in the first quarter as a result of higher levels of restocking orders placed by retailers. Our management currently believes that our inventory levels at our major customers at the end of 2003 were at or near retailers' target inventory levels.

Increasing the number of company-owned stores would generally amplify our seasonality by decreasing our operating income in the first half of the year while increasing operating income during the second half of the year. In addition, new product launches would generally augment the sales and operating expense levels in the quarter the product launch takes place. The results of operations for a particular quarter may also vary due to a number of factors, including retail, economic and monetary conditions, timing of orders or holidays and the mix of products sold by us.

## Business

### General

We are a leader in the design, development, marketing and distribution of contemporary, high quality fashion watches and accessories. We developed the FOSSIL brand name to convey a distinctive fashion, quality and value message and a brand image reminiscent of an earlier era that suggests a time of fun, fashion and humor. Since our inception in 1984, we have grown into a diversified company offering an extensive line of fashion watches under our proprietary FOSSIL, RELIC and ZODIAC brands and, pursuant to license agreements, under some of the most prestigious brands in the world, including BURBERRY, DIESEL, DKNY and EMPORIO ARMANI. Additionally, we offer a wide range of accessories including small leather goods, belts, handbags, and sunglasses under the FOSSIL and RELIC brands, jewelry under the FOSSIL and EMPORIO ARMANI brands and FOSSIL brand apparel. We leverage our centralized design/development and production/sourcing expertise by distributing these products through its global distribution network.

Domestically, we sell our products in approximately 20,500 retail locations in the United States through a diversified distribution network that includes approximately 7,500 department store doors, such as Federated/Macy's, Saks, Nordstroms, May Department Stores, and Dillard's for our FOSSIL brand and certain licensed brands and JCPenney, Kohls and Sears for our RELIC brand, and approximately 13,000 specialty retail locations. We also sell our products in the United States through a network of 98 company-owned stores, with 44 retail stores located in premier retail sites and 54 outlet stores located in major outlet malls. We also offer selected FOSSIL and licensed brand products at our website, www.fossil.com.

Internationally, our products are also sold to department stores and specialty retail stores in over 90 countries worldwide through company-owned foreign sales subsidiaries and through a network of approximately 60 independent distributors. Our products can be found in Australia, Europe, Central and South America, Canada, the Caribbean, the Far East, Mexico, and the Middle East. Our products are offered on cruise ships, on airplanes and in 22 international company-owned FOSSIL retail stores. 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 2,760,000 shares of our common stock. We conduct a majority of our operations in the United States through Fossil Partners, L.P., a Texas limited partnership formed in 1994 of which we are sole general partner. We also conduct operations in the United States and certain international markets through various directly and indirectly owned subsidiaries. Our operations in Hong Kong relating to the procurement of watches from various manufacturing sources are conducted by Fossil (East) Ltd., a wholly owned subsidiary of ours acquired in 1992. 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.

### Industry overview

#### *Watch products*

We believe that the current market for watches in the United States can be divided into four segments. One segment of the market consists of fine watches characterized by internationally known brand names such as Concord, 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 often 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 second segment of the market consists of fine premium branded and designer watches manufactured in Switzerland and the Far East such as Gucci, Rado, Raymond Weil, Seiko and Swiss Army. These watches are sold at retail prices generally ranging from $150 to $1,500. Our BURBERRY, EMPORIO ARMANI and ZODIAC lines generally compete in this market segment. A third segment of the market consists of watches sold by mass marketers, which include certain watches sold under the Timex brand name as well as certain watches sold by Armitron under various brand names and labels. Retail prices in this segment range from $5 to $40. We intend to enter this segment in 2004.

The fourth segment of the market consists of moderately priced watches characterized by contemporary fashion and well known brand names. Moderately priced watches are typically manufactured 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 Guess?, Anne Klein II, Kenneth Cole and Swatch brand names, whose products attempt to reflect emerging fashion trends in accessories and apparel. Our DKNY and DIESEL lines generally compete in this segment as well. 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 resulted in consumers owning multiple watches that may differ significantly in terms of style, features and cost.

***Fashion accessories***

We believe that the fashion accessories market in the United States includes 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 Coach, Dooney & Burke, Ralph Lauren and Donna Karan New York.

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, and eyewear for both men and women through department stores and specialty retailers in the moderate to upper-moderate price range. Companies such as Tommy Hilfiger, Guess?, Nine West, Kenneth Cole and Liz Claiborne currently operate in this market. In addition, we offer fashion jewelry sold under the FOSSIL and EMPORIO ARMANI brands.

***Apparel***

In 2000, we introduced a line of FOSSIL apparel that is distributed exclusively through company-owned retail stores and our website. Selling through company-owned stores allows us to effectively manage visual presentation, information feedback, inventory levels and operating returns. The apparel line is focused on the casual lifestyle of 16 to 24 year old consumers and consists primarily of jeans, tee shirts, and sweatshirts featuring FOSSIL brand packaging and labeling. The suggested retail selling price of the apparel line is comparable to that of major competitors like American Eagle Outfitters and Gap. We have leveraged our existing graphic and store design infrastructure to create a unique product packaging and store concept that differentiates it from other competitors in order to create higher perceived value for the products.

**Business strategy**

Our long-term goal is to capitalize on the strength of our growing consumer brand recognition and capture an increasing share of a growing number of markets by providing consumers with fashionable, high quality, value-driven products. In pursuit of this goal, we have adopted operating and growth strategies that provide the framework for our future growth, while maintaining the consistency and integrity of our brands.

**Operating strategy**

*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 its other accessories.

*Coordinated product promotion.* We coordinate in-house product design, packaging, advertising 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 FOSSIL brand products and certain of our accessory products are packaged in metal tins decorated with designs consistent with our marketing strategy and product image. In addition, we generally market our fashion accessory lines through the same distribution channels as our watch lines, using similar in-store presentations, graphics and packaging.

*Product value.* Our products provide value to the consumer by offering fashionable, high quality components and features at suggested retail prices generally below those of competitive products of comparable quality based on our market research. We are able to offer certain of our watches at a reasonable price point by manufacturing them principally in the Far East at lower cost than comparable quality watches manufactured in Switzerland. In addition, we are able to offer our accessories at reasonable prices because of our close relationships with manufacturers in the Far East.

*Captive suppliers.* We own a majority interest in a number of watch assemblers with locations in China. In addition, although we do not have long-term contracts with our 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 the same manufacturers and because of the small amount of turnover in the employees of our manufacturers. In addition, our employees regularly visit the manufacturing facilities. We believe that we are able to exert significant operational control with regard to our watch assemblers because of our majority ownership and we believe that the existence of our relationships with our accessory manufacturers create a significant competitive advantage, specifically because manufacturers have limited production capacity and our majority ownership and relationships ensure that we are granted access. 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 by monitoring customer sales and inventory levels by product category and style, primarily through electronic data interchange, and by assisting retailers 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 retailers, often allowing us to influence the mix, quantity and timing of customer purchasing decisions.

*Centralized distribution.* We distribute substantially all of our products sold in the United States and certain of our products sold in international markets from our warehouse and distribution center in Dallas, Texas. We also distribute our products to international markets from warehouse and distribution centers located in Australia, France, Germany, Hong Kong, Italy, Japan, Singapore, Switzerland and the United Kingdom. In September 2003, we opened a new 100,000 square foot distribution facility in Germany. This facility will support our current distribution operations in Germany, allow us to consolidate our European distribution sites and further support future growth throughout Europe. We believe our centralized distribution capabilities enable us to reduce inventory risk, increase flexibility in meeting the delivery requirements of our customers and maintain significant cost advantages as compared to our competitors.

**Growth strategy**

*Introduce new products and brands.* We continually introduce new products within our existing brands and through license agreements, brand extensions and acquisitions to attract a wide range of consumers with differing tastes and lifestyles. For example, we currently offer a full line of fashion watch and accessory products under our FOSSIL and RELIC brands, as well as watches under the BURBERRY, DIESEL, DKNY and EMPORIO ARMANI brand names pursuant to license agreements. We have also entered the market for Swiss-made watches with our ZODIAC, ANTIMA, and BURBERRY lines. In addition, we have entered the market for technology-enhanced watches pursuant to license agreements with PalmSource and Microsoft. Under the licensing agreement with PalmSource, which obligates us to pay royalty commitments, we will produce a watch that contains the Palm OS® platform. The Palm OS® platform will allow users to have a fully functioning Palm on their wrist. Under the licensing agreement with Microsoft, for which no royalty commitments are due, we produce watches that incorporate Microsoft's "SPOT" (Smart Personal Objects Technology) technology. The SPOT technology allows users to receive customized information via FM subcarrier transmissions.

*Expand international business.* We have increased FOSSIL brand advertising internationally to accelerate brand recognition. We have also purchased former distributors and entered into joint venture relationships to gain increased control over the brand and develop global marketing efforts. We continue to introduce licensed brand products into international markets, open FOSSIL stores and develop new product lines.

*Leverage infrastructure.* We believe we have the design, marketing, manufacturing and distribution infrastructure in place to allow us to manage and grow our businesses. We continue to develop additional products and brands and seek additional businesses and products to complement our existing product lines allowing us to leverage our infrastructure.

*Expand retail locations.* We have historically expanded our company-owned FOSSIL retail and outlet locations to further strengthen our brand image. We currently operate 120 retail and outlet stores worldwide and plan to open an additional 12 to 16 stores in 2004. We also offer our watch and accessory products through authorized FOSSIL retail stores in airports, on cruise ships and in certain international markets.

**Products**

We design, develop, market and distribute fashion watches and accessories, including sunglasses, small leather goods, belts, and handbags principally under the FOSSIL and RELIC brand names, FOSSIL brand apparel and jewelry, and watches bearing the brand names of certain internationally known fashion companies pursuant to license agreements.

***Watch products***

We offer an extensive line of fashion watches under our proprietary brands and, pursuant to license agreements, under some of the most prestigious brands in the world. Sales of watches for fiscal years

2003, 2002 and 2001 accounted for approximately 70.2%, 69.3%, and 68.1%, respectively, of our net sales. For the 13 weeks ended April 3, 2004, watch sales accounted for 65.4% of our net sales.

The following table sets forth certain information with respect to our company's owned-brand watches:

| Watch Brand | Product Categories | Suggested Price Point Range | Territory | Distribution Channels |
|---|---|---|---|---|
| FOSSIL | FOSSIL BLUE, $F^2$, FUEL, BIG TIC, ARKITEKT, TITANIUM, SPEEDWAY | $55 - 165 | Worldwide | |