STEVEN MADDEN, LTD.
Form 10-Q
November 09, 2011
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2011
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from $\qquad$ to $\qquad$
Commission File Number 0-23702

## STEVEN MADDEN, LTD. <br> (Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

52-16 Barnett Avenue, Long Island City, New York
(Address of principal executive offices)

13-3588231
(I.R.S. Employer Identification No.)

11104
(Zip Code)

Registrant's telephone number, including area code (718) 446-1800
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T ( $\$ 232.405$ of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
$\begin{array}{ll}\text { Large accelerated filer } \mathrm{x} & \text { Accelerated filer o } \\ \text { Non-accelerated filer } \mathrm{o} \text { (do not check if smaller reporting company) } & \text { Smaller reporting company o }\end{array}$

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x
As of November 4, 2011, the latest practicable date, there were $42,866,477$ shares of common stock, $\$ .0001$ par value, outstanding.

STEVEN MADDEN, LTD.<br>FORM 10-Q<br>QUARTERLY REPORT

September 30, 2011

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## PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements STEVEN MADDEN, LTD. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (in thousands)

|  | September 30, 2011 <br> (unaudited) |  | $\begin{gathered} \text { December 31, } \\ 2010 \end{gathered}$ |  | September 30, 2010 (unaudited) |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| ASSETS |  |  |  |  |  |  |
| Current assets: |  |  |  |  |  |  |
| Cash and cash equivalents | \$ | 35,141 | \$ | 66,151 | \$ | 29,045 |
| Accounts receivable, net of allowances of $\$ 7,114$, \$2,458 and \$2,209 |  | 113,461 |  | 18,742 |  | 12,846 |
| Due from factors, net of allowances of $\$ 12,496$, \$12,800 and \$10,934 |  | 105,694 |  | 52,206 |  | 81,815 |
| Inventories |  | 77,042 |  | 39,557 |  | 44,485 |
| Marketable securities - available for sale |  | 4,159 |  | 13,289 |  | 20,395 |
| Prepaid expenses and other current assets |  | 14,465 |  | 11,044 |  | 11,590 |
| Deferred taxes |  | 9,415 |  | 9,078 |  | 8,827 |
| Total current assets |  | 359,377 |  | 210,067 |  | 209,003 |
|  |  |  |  |  |  |  |
| Notes receivable |  | 7,318 |  | 7,024 |  | 33,195 |
| Note receivable - related party |  | 4,028 |  | 3,849 |  | 3,791 |
| Property and equipment, net |  | 30,400 |  | 20,791 |  | 21,054 |
| Deferred income taxes |  | 4,665 |  | 7,844 |  | 6,309 |
| Deposits and other |  | 1,970 |  | 2,529 |  | 2,775 |
| Marketable securities - available for sale |  | 72,500 |  | 114,317 |  | 103,179 |
| Goodwill - net |  | 74,976 |  | 38,613 |  | 36,613 |
| Intangibles - net |  | 95,780 |  | 42,662 |  | 14,095 |
| Total Assets | \$ | 651,014 | \$ | 447,696 | \$ | 430,014 |
|  |  |  |  |  |  |  |
| LIABILITIES |  |  |  |  |  |  |
| Current liabilities: |  |  |  |  |  |  |
| Accounts payable | \$ | 86,894 | \$ | 37,089 | \$ | 37,302 |
| Accrued expenses |  | 34,864 |  | 18,425 |  | 21,525 |
| Contingent payment liability - current portion |  | 3,787 |  | 1,976 |  | 1,628 |
| Income taxes payable |  | 22,877 |  | - |  | 5,935 |
| Accrued incentive compensation |  | 13,402 |  | 15,917 |  | 11,864 |
| Total current liabilities |  | 161,824 |  | 73,407 |  | 78,254 |
|  |  |  |  |  |  |  |
| Contingent payment liability |  | 36,236 |  | 10,396 |  | 10,372 |
| Deferred rent |  | 5,799 |  | 5,467 |  | 5,494 |
| Other liabilities |  | 154 |  | 1,128 |  | 1,577 |
| Total Liabilities |  | 204,013 |  | 90,398 |  | 95,697 |

Commitments, contingencies and other (Note W)

## STOCKHOLDERS' EQUITY

Preferred stock - \$. 0001 par value, 5,000 shares
authorized; none issued; Series A Junior
Participating preferred stock - $\$ .0001$ par value, 60
shares authorized; none issued
Common stock - $\$ .0001$ par value, 60,000 shares authorized, $51,271,50,423$ and 49,982 shares


See accompanying notes to condensed consolidated financial statements - unaudited

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

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

|  | Three Months Ended September 30, |  |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2011 |  | 2010 |  | 2011 |  | 2010 |
| Net sales | \$313,887 |  | \$184,118 |  | \$688,794 |  | \$474,390 |
| Cost of sales | 204,434 |  | 106,610 |  | 426,114 |  | 268,096 |
| Gross profit | 109,453 |  | 77,508 |  | 262,680 |  | 206,294 |
| Commission, royalty and licensing fee income - net | 5,649 |  | 6,587 |  | 14,648 |  | 18,000 |
| Operating expenses | (64,594 | ) | (46,707 | ) | (162,177 | ) | (129,994 |
| Income from operations | 50,508 |  | 37,388 |  | 115,151 |  | 94,300 |
| Interest and other income, net | 1,732 |  | 1,201 |  | 4,905 |  | 2,927 |
| Income before provision for income taxes | 52,240 |  | 38,589 |  | 120,056 |  | 97,227 |
| Provision for income taxes | 20,372 |  | 15,673 |  | 46,641 |  | 39,127 |
| Net income | 31,868 |  | 22,916 |  | 73,415 |  | 58,100 |
| Net loss attributable to noncontrolling interests | 43 |  | - |  | 132 |  | - |
| Net income attributable to Steven Madden, Ltd. | \$31,911 |  | \$22,916 |  | \$73,547 |  | \$58,100 |
| Basic income per share | \$0.75 |  | \$0.55 |  | \$1.74 |  | \$ 1.40 |
| Diluted income per share | \$0.74 |  | \$0.54 |  | \$1.70 |  | \$1.37 |
| Basic weighted average common shares outstanding | 42,430 |  | 41,520 |  | 42,180 |  | 41,390 |
| Effect of dilutive securities - options/restricted stock | 977 |  | 833 |  | 973 |  | 965 |
| Diluted weighted average common shares outstanding | 43,407 |  | 42,353 |  | 43,153 |  | 42,355 |

See accompanying notes to condensed consolidated financial statements - unaudited

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (unaudited)
(in thousands)

|  | Nine Months Ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2011 |  | 2010 |  |
| Cash flows from operating activities: |  |  |  |  |
| Net income | \$73,415 |  | \$58,100 |  |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |  |
| Excess tax benefit from the exercise of options | (4,178 | ) | (2,882 |  |
| Depreciation and amortization | 7,849 |  | 7,364 |  |
| Loss on disposal of fixed assets | 609 |  | 543 |  |
| Non-cash compensation | 8,337 |  | 5,963 |  |
| Provision for bad debts | 4,352 |  | (539 | ) |
| Accrued interest on note receivable - related party | (179 | ) | (223 | ) |
| Deferred rent expense | (556 | ) | 463 |  |
| Realized gain on marketable securities | (1,254 | ) | (32 | ) |
| Changes in (net of acquisitions): |  |  |  |  |
| Accounts receivable | (40,030 | ) | (2,121 | ) |
| Due from factor | (53,184 | ) | (32,728 | ) |
| Inventories | (25,301 | ) | (13,732 | ) |
| Prepaid expenses, deposits and other assets | (2,329 | ) | (4,216 | ) |
| Accounts payable and other accrued expenses | 41,969 |  | 26,534 |  |
| Other liabilities | (2,135 | ) | (102 |  |
| Net cash provided by operating activities | 7,385 |  | 42,392 |  |
| Cash flows from investing activities: |  |  |  |  |
| Purchase of property and equipment | (12,246 | ) | (2,280 | ) |
| Purchase of marketable securities | (13,983 | ) | (54,341 | ) |
| Sale/redemption of marketable securities | 64,885 |  | 18,592 |  |
| Purchase of notes receivable | - |  | (34,186 | ) |
| Acquisitions, net of cash acquired | (85,234 | ) | (11,119 | ) |
| Net cash used in investing activities | (46,578 | ) | (83,334 | ) |
| Cash flows from financing activities: |  |  |  |  |
| Proceeds from options exercised | 4,005 |  | 2,398 |  |
| Tax benefit from exercise of options | 4,178 |  | 2,882 |  |
| Purchase of common stock for treasury | - |  | (4,559 | ) |
| Net cash provided by financing activities | 8,183 |  | 721 |  |
| Net decrease in cash and cash equivalents | (31,010 | ) | (40,221 | ) |
| Cash and cash equivalents - beginning of period | 66,151 |  | 69,266 |  |

Cash and cash equivalents - end of period
\$35,141
\$29,045

See accompanying notes to condensed consolidated financial statements - unaudited
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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)

## Note A - Basis of Reporting

The accompanying unaudited condensed consolidated financial statements of Steven Madden, Ltd. and subsidiaries (the "Company") have been prepared in accordance with the generally accepted accounting principles in the United States of America ("GAAP") for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, such statements include all adjustments (consisting only of normal recurring items) which are considered necessary for a fair presentation of the financial position of the Company and the results of its operations and cash flows for the periods presented. The results of its operations for the three- and nine-month periods ended September 30, 2011 are not necessarily indicative of the operating results for the full year. It is suggested that these financial statements be read in conjunction with the financial statements and related disclosures for the year ended December 31, 2010 included in the Annual Report of Steven Madden, Ltd. on Form 10-K filed with the SEC on February 28, 2011.

## Note B - Stock Split

On May 5, 2011, the Company's Board of Directors announced a three-for-two stock split of the Company's outstanding shares of common stock, effected in the form of a stock dividend on the Company's outstanding common stock. Stockholders of record at the close of business on May 20, 2011 received one additional share of Steven Madden, Ltd. common stock for every two shares of common stock owned on this date. The additional shares were distributed on May 31, 2011. Stockholders received cash in lieu of any fractional shares of common stock they otherwise would have received in connection with the dividend. All share and per share data provided herein gives effect to this stock split, applied retroactively.

Note C - Recently Adopted Accounting Standards
In September 2011, the FASB issued Accounting Standards Update No. 2011-08, "Intangibles - Goodwill and Other" ("ASU 2011-08"). Under ASU 2011-08, when testing goodwill for impairment, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not (a likelihood of more than $50 \%$ ) that the fair value of a reporting unit is less than its carrying amount. If an entity believes, as a result of its qualitative assessment that the fair value of a reporting unit is less than its carrying amount, performing the current two-step impairment test is not required. The guidance also includes a number of events and circumstances that an entity should consider in conducting the qualitative assessment. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted if an entity has not yet issued financial statements for the most recent annual or interim period, provided the entity has not yet performed its annual impairment test. We do not expect this guidance to have a material impact on our financial statements..

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-05 "Comprehensive Income (Topic 220): Presentation of Comprehensive Income" ("ASU No. 2011-05"). Under ASU No. 2011-5, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Regardless of which option is selected, an entity is required to present each
component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. ASU No. 2011-5 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. ASU No. 2011-5 is effective for fiscal years, and interim periods within those years, beginning after December 15,2011 , and effects the presentation of financial statements and thus will have no impact on the Company's consolidated financial statements. In October 2011, the FASB announced plans to defer the presentation of items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income.

## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)
Note C - Recently Adopted Accounting Standards (continued)
May 2011, the FASB issued ASU No. 2011-04 "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements" ("ASU No. 2011-04") under GAAP and under the International Financial Reporting Standards ("IFRS"). ASU No. 2011-04 amends FASB ASC Topic 820, "Fair Value Measurements and Disclosures", to establish common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and IFRS. ASU No. 2011-04 is effective for interim and annual periods beginning after December 15, 2011. Management is currently evaluating ASU No. 2011-04 and does not believe that it will have a material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued ASU No. 2010-28, "When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts" ("ASU No. 2010-28"). ASU No. 2010-28 modifies Step 1 of the goodwill impairment test, which requires an entity to compare the fair value of a reporting unit with its carrying amount, including goodwill. For reporting units with zero or negative carrying amounts, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. Step 2 requires an entity to compare the fair value of a reporting unit goodwill with the carrying amount of that goodwill. The implied fair value of goodwill is determined by assigning a fair value to all the assets and liabilities of the reporting unit as if the reporting unit had been acquired in a business combination. The adoption of ASU No. 2010-28, which became effective for the Company on January 1, 2011, did not have a material impact on the Company's consolidated financial statements.

In December 2010, FASB issued ASU No. 2010-29 "Business Combination (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations" ("ASU No. 2010-29"). ASU no. 2010-29 specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. ASU No. 2010-29 also expands the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. ASU No. 2010-29 is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The adoption of ASU No. 2010-29 did not have a material impact on the Company's consolidated financial statements.

Note D - Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Significant areas involving management estimates include allowances for bad debts, returns and customer chargebacks and contingent payment liability. The Company provides reserves on trade accounts receivables and due from factors for future customer chargebacks and markdown allowances, discounts, returns and other miscellaneous compliance related deductions that relate to the current period sales. The Company evaluates anticipated chargebacks
by reviewing several performance indicators of its major customers. These performance indicators, which include retailers' inventory levels, sell-through rates and gross margin levels, are analyzed by management to estimate the amount of the anticipated customer allowance.

## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)

Note E- Due To and From Factor

The Company has a collection agency agreement with Rosenthal \& Rosenthal, Inc. ("Rosenthal") that became effective on September 15, 2009. The agreement can be terminated by the Company or Rosenthal at any time upon 60 days' prior written notice. Under the agreement, the Company can request advances from Rosenthal of up to $85 \%$ of aggregate receivables submitted to Rosenthal. The agreement provides the Company with a $\$ 30$ million credit facility with a $\$ 15$ million sub-limit for letters of credit, at an interest rate based, at the Company's election, upon either the prime rate or LIBOR. The Company also pays a fee of $0.275 \%$ of the gross invoice amount submitted to Rosenthal. Rosenthal assumes the credit risk on a substantial portion of the receivables the Company refers to it and, to the extent of any loans made to the Company, Rosenthal maintains a lien on all of the Company's receivables to secure the Company's obligations. On February 10, 2010, the agreement was amended to include foreign accounts receivable.

Note F - Notes Receivable
As of September 30, 2011, Notes Receivable were comprised of the following:

| Due from Bakers Footwear Group, Inc. | $\$ 4,074$ |
| :--- | ---: |
| Due from Betsey Johnson LLC (see Note S) | 3,244 |
| Total | $\$ 7,318$ |

On August 26, 2010, the Company entered into a Debenture and Stock Purchase Agreement with Bakers Footwear Group, Inc. ("Bakers") pursuant to which the Company paid $\$ 5,000$ to acquire a subordinated debenture in the principal amount of $\$ 5,000$ and $1,844,860$ unregistered shares of Bakers common stock which trades on the Over-the-Counter Bulletin Board. The Company allocated $\$ 996$ of the purchase price to the common stock and $\$ 4,004$ to the subordinated debenture based upon their relative fair values. Interest accrues on the debenture at the rate of $11 \%$ per annum and is payable quarterly in cash. The principal amount of the debenture is payable by Bakers in four equal installments of $\$ 1,250$ due on August 31, 2017, 2018, 2019 and 2020. The difference between the $\$ 4,004$ purchase price of the debenture and the $\$ 5,000$ principal amount of the debenture is considered original issue discount and is being amortized over the life of the debenture. As of September 30, 2011, the total amount of the discount amortized was $\$ 70$, bringing the value of the note to $\$ 4,074$.

Note G - Note Receivable - Related Party
On June 25, 2007, the Company made a loan to Steve Madden, its Creative and Design Chief and a principal stockholder of the Company, in the amount of $\$ 3,000$ in order for Mr. Madden to satisfy a personal tax obligation resulting from the exercise of options that were due to expire and retain the underlying Company common stock, which he pledged to the Company as collateral to secure the loan. Mr. Madden executed a secured promissory note in favor of the Company bearing interest at an annual rate of $8 \%$, which was due on the earlier of the date Mr. Madden ceases to be employed by the Company or December 31, 2007. The note was amended and restated as of December 19, 2007 to extend the maturity date to March 31, 2009, and amended and restated again as of April 1, 2009 to change the interest rate to $6 \%$ and extend the maturity date to June 30,2015 when all principal and accrued interest is due. As of September 30, 2011, $\$ 1,028$ of interest has accrued on the note and has been reflected on the Company's Condensed Consolidated Financial Statements. Due to the 3-for-2 stock split effected on May 3, 2010 the number of shares
securing the loan increased from 510,000 shares to 765,000 shares. Based upon the increase in the market value of the Company's common stock since the inception of the loan, on July 12, 2010, the Company released from its security interest 555,000 shares of the Company's common stock, retaining 210,000 shares with a total market value on that date of $\$ 6,798$, as collateral for the loan. Subsequently, pursuant to the 3 -for-2 stock split effected on May 31, 2011 (see Note B above), the number of shares securing the loan has increased from 210,000 shares to 315,000 shares. On September 30, 2011, the total market value of these shares was $\$ 9,482$.

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)

## Note H-Marketable Securities

Marketable securities consist primarily of corporate and U.S. government and federal agency bonds with maturities greater than three months and up to six years at the time of purchase as well as marketable equity securities. These securities, which are classified as available-for-sale, are carried at fair value, with unrealized gains and losses, net of any tax effect, reported in stockholders' equity as accumulated other comprehensive income (loss). These securities are classified as current and non-current marketable securities based upon their maturities. Amortization of premiums and discounts is included in interest income. For the three- and nine-month periods ended September 30, 2011, the amortization of bond premiums totals $\$ 234$ and $\$ 898$, respectively, compared to $\$ 320$ and $\$ 822$ for the comparable periods in 2010. The values of these securities may fluctuate as a result of changes in market interest rates and credit risk.

## Note I - Fair Value Measurement

The accounting guidance under Accounting Standards Codification ("ASC") "Fair Value Measurements and Disclosures" ("ASC 820-10") permits the Company to elect to measure non-financial assets and non-financial liabilities at fair value effective January 1, 2009. ASC 820-10 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. ASC 820-10 utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. A brief description of those three levels is as follows:

Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.
Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.
Level 3: Significant unobservable inputs.
The Company's financial assets subject to fair value measurements as of September 30, 2011 are as follows:

\left.|  |  | Fair Value Measurements |  |  |
| :--- | :---: | :---: | :---: | :---: |
|  | Fair value | Level 1 | Lsing Fair Value Hierarchy |  |
| Level 2 |  |  |  |  |$\right]$ Level 3


| Liabilities: |  |  |  |  |
| :--- | :---: | :---: | :---: | :---: |
| Contingent consideration - Big Buddha, current | $\$ 3,787$ | - | - | $\$ 3,787$ |
| Contingent consideration - Cejon, non-current | 23,500 | - | - | 23,500 |
| Contingent consideration - Topline, <br> non-current | 6,200 | - | - | 6,200 |
| Contingent consideration - Big Buddha, <br> non-current | 6,536 | - | - | 6,536 |
| Total liabilities | $\$ 40,023$ | - | - | $\$ 40,023$ |

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)
Note I - Fair Value Measurement (continued)
The Company's financial assets subject to fair value measurements as of December 31, 2010 are as follows:

|  | Fair Value Measurements |  |  |
| :---: | :---: | :---: | :---: |
| Using Fair Value Hierarchy |  |  |  |
| Fair value | Level 1 | Level 2 | Level 3 |


| Assets: |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
| Cash equivalents | \$32,145 | \$32,145 | \$- | \$- |
| Current marketable securities - available for sale | 13,289 | 13,289 | - | - |
| Investment in Bakers | 996 | - | 996 | - |
| Note receivable - Bakers | 4,024 | - | - | 4,024 |
| Note receivable - Betsey Johnson | 3,000 | - | - | 3,000 |
| Long-term marketable securities - available for sale | 114,317 | 114,317 | - | - |
| Total assets | \$167,771 | \$159,751 | \$996 | \$7,024 |
| Liabilities: |  |  |  |  |
| Contingent consideration | \$12,372 | - | - | \$12,372 |
| Total liabilities | \$12,372 | - | - | \$ 12,372 |

Pursuant to the Debenture and Stock Purchase Agreement with Bakers (see Note F), the Company acquired 1,844,860 unregistered shares of Bakers common stock, which trades on the OTC Bulletin Board. These shares, which are thinly traded, were valued using the quoted price of similar registered shares of Bakers common stock adjusted for the effect of the transfer restriction, considering factors such as the nature and duration of the transfer restriction, the volatility of the stock and the risk free interest rate. The shares are included in deposits and other assets on the Company's Condensed Consolidated Balance Sheets. For the note receivable due from Bakers (see Note F), which was purchased at a substantial discount, the carrying value was determined to be the fair value. For the note receivable due from Betsey Johnson (see Note S), the carrying value was determined to be the fair value.

The Company has recorded a liability for contingent consideration as a result of the May 25, 2011 acquisition of Cejon, Inc., Cejon Accessories, Inc. and New East Designs, LLC (collectively, "Cejon") (see Note S). Pursuant to the terms of the acquisition, earn-out payments may be due annually to the sellers of Cejon based on the financial performance of Cejon for each of the twelve-month periods ending on June 30, 2012 through 2016, inclusive. The fair value of the contingent payments was estimated using the present value of management's projections of the financial results of Cejon during the earn-out period.

The Company has recorded a liability for contingent consideration as a result of the May 20, 2011 acquisition of the Topline Corporation ("Topline") (see Note S). Pursuant to the terms of the acquisition, an earn-out payment may be due to the seller of Topline based on the financial performance of Topline for the twelve-month period ending on June 30, 2012. The fair value of the contingent payment was estimated using the present value of management's projections of the financial results of Topline during the earn-out period.

The Company has recorded a liability for contingent consideration as a result of the February 10, 2010 acquisition of Big Buddha, Inc. (see Note S). Pursuant to the terms of the acquisition, earn-out payments may be due annually to the seller of Big Buddha based on the financial performance of Big Buddha for each of the twelve-month periods ending on March 31, 2012 and 2013. The fair value of the contingent payments was estimated using the present value of management's projections of the financial results of Big Buddha during the earn-out period. The contingent payment for the twelve-month period ended March 31, 2011 was $\$ 3,603$.

## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)
Note J- Fair Value of Financial Instruments
The carrying value of certain financial instruments such as accounts receivable, due from factors and accounts payable approximate their fair values due to the short-term nature of their underlying terms. The fair values of these financial instruments are determined by reference to market data and other valuation techniques, as appropriate. Fair value of the note receivable - related party approximates its carrying value based upon its interest rate, which approximates current market interest rates.

## Note K- Inventories

Inventories, which consist of finished goods on hand and in transit, are stated at the lower of cost (first-in, first-out method) or market.

## Note L- Revenue Recognition

The Company recognizes revenue on wholesale sales when products are shipped pursuant to its standard terms, which are freight on board ("FOB") warehouse, or when products are delivered to the consolidators as per the terms of the customers' purchase order, persuasive evidence of an arrangement exists, the price is fixed or determinable and collection is reasonably assured. Sales reductions for anticipated discounts, allowances and other deductions are recognized during the period when sales are recorded. Customers retain the right to replacement of the product for poor quality or improper or short shipments, which have historically been immaterial. Retail sales are recognized when the payment is received from customers and are recorded net of returns. The Company also generates commission income acting as a buying agent by arranging to manufacture private label shoes to the specifications of its clients. The Company's commission revenue includes partial recovery of its design, product and development costs for the services provided to certain suppliers in connection with the Company's private label business. Commission revenue and product and development cost recoveries are recognized as earned when title to the product transfers from the manufacturer to the customer and collections are reasonably assured and are reported on a net basis after deducting related operating expenses.

The Company licenses its Steve Madden ${ }^{\circledR}$ and Steven by Steve Madden® trademarks for use in connection with the manufacture, marketing and sale of sunglasses, eyewear, outerwear, bedding, hosiery, women's fashion apparel and jewelry. The Company licenses its Big Buddha ${ }^{\circledR}$ brand for use in connection with the manufacture, marketing and sale of sunglasses and cold weather accessories. In addition, the Company licenses the Betsey Johnson® and Betseyville® trademarks for use in connection with the manufacture, marketing and sale of apparel, jewelry, lingerie, swimwear, eyewear, watches and outerwear. The license agreements require the licensee to pay the Company a royalty and, in substantially all of the agreements, an advertising fee based on the higher of a minimum or a net sales percentage as defined in the various agreements. In addition, under the terms of retail selling agreements, most of the Company's international distributors are required to pay the Company a royalty based on a percentage of net sales, in addition to a commission and a design fee on the purchases of the Company's products. Licensing revenue is recognized on the basis of net sales reported by the licensees, or the minimum guaranteed royalties, if higher. In substantially all of the Company's license agreements, the minimum guaranteed royalty is earned and payable on a quarterly basis.

## Note M- Taxes Collected From Customers

The Company accounts for certain taxes collected from its customers in accordance with the accounting guidance which permits companies to adopt a policy of presenting taxes in the income statement on either a gross basis (included in revenues and costs) or a net basis (excluded from revenues). Taxes within the scope of the accounting guidance would include taxes that are imposed on a revenue transaction between a seller and a customer, for example, sales taxes, use taxes, value-added taxes and some types of excise taxes. The Company has consistently recorded all taxes on a net basis.

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
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(\$ in thousands except share and per share data)

Note $\mathrm{N}-$ Sales Deductions

The Company supports retailers' initiatives to maximize sales of the Company's products on the retail floor by subsidizing the co-op advertising programs of such retailers, providing them with inventory markdown allowances and participating in various other marketing initiatives of its major customers. In addition, the Company accepts returns for damaged products for which the Company's costs are normally charged back to the responsible factory. Such expenses are reflected in the financial statements as deductions to net sales.

## Note O- Cost of Sales

All costs incurred to bring finished products to the Company's distribution center and, in the Retail segment, the costs to bring products to the Company's stores, are included in the cost of sales line on the Condensed Consolidated Statement of Income. These include the cost of finished products, purchase commissions, letter of credit fees, brokerage fees, sample expenses, custom duty, inbound freight, royalty payments on licensed products, labels and product packaging. All warehouse and distribution costs related to the Wholesale segments and freight to customers, if any, are included in the operating expenses line item of the Company's Condensed Consolidated Statements of Income. The Company's gross margins may not be comparable to those of other companies in the industry because some companies may include warehouse and distribution costs, as well as other costs excluded from cost of sales by the Company, as a component of cost of sales, while other companies report on the same basis as the Company and include them in operating expenses.

## Note P - Income Taxes

The Company's effective income tax rate for the nine months ended September 30, 2011 and 2010 was $38.8 \%$ and $40.2 \%$, respectively. The primary reason for this decrease is that this year's tax provision does not include a valuation allowance while last year's tax provision included a valuation allowance that increased the effective tax rate by 74 basis points. A decrease in expenses that are non-deductible for tax purposes also contributed to the lower effective income tax rate in the first quarter of 2011.

## Note Q-Net Income Per Share of Common Stock

Basic net income per share is based on the weighted average number of shares of common stock outstanding during the period. Diluted net income per share reflects: (a) the potential dilution assuming shares of common stock were issued upon the exercise of outstanding in-the-money options and the proceeds thereof were used to purchase treasury stock at the average market price during the period, and (b) the vesting of granted nonvested restricted stock awards for which the assumed proceeds upon grant are deemed to be the amount of compensation cost attributable to future services and are not yet recognized using the treasury stock method, to the extent dilutive. For the three- and nine-month periods ended September 30, 2011, options to purchase 19,000 and 169,000 shares, respectively, of the Company's common stock have been excluded from the calculation because inclusion of such shares would be anti-dilutive as compared with options to purchase 177,100 shares of the Company's common stock that have been excluded from the calculation for both the three and nine months ended September 30, 2010.

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
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## Note R-Stock-Based Compensation

In March 2006, the Board of Directors approved the Steven Madden, Ltd. 2006 Stock Incentive Plan (the "Plan") under which nonqualified stock options, stock appreciation rights, performance shares, restricted stock, other stock-based awards and performance-based cash awards may be granted to employees, consultants and non-employee directors. The stockholders approved the Plan on May 26, 2006. On May 25, 2007, the stockholders approved an amendment to the Plan to increase the maximum number of shares that may be issued under the Plan from $2,700,000$ to $3,487,500$. On May 22, 2009, the stockholders approved a second amendment to the Plan that increased the maximum number of shares that may be issued under the Plan to $9,144,000$. The following table summarizes the number of shares of common stock authorized for use under the Plan, the number of stock-based awards granted (net of expired or cancelled awards) under the Plan and the number of shares of common stock available for the grant of stock-based awards under the Plan:

$$
\text { Common Stock authorized } \quad 9,144,000
$$

Stock based awards, including restricted stock and stock options granted, net of expired or cancelled 6,374,000

Common Stock available for grant of stock-based awards as of September 30, 2011 2,770,000

Total equity-based compensation expense for the three and nine months ended September 30 is as follows:

|  | Three Months Ended September 30, |  |  |  | Nine Months Ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2011 |  | 2010 |  | 2011 |  | 2010 |  |
| Restricted stock | \$ | 1,093 | \$ | 1,110 | \$ | 4,050 | \$ | 3,440 |
| Stock options |  | 1,679 |  | 1,177 |  | 4,287 |  | 2,523 |
| Total | \$ | 2,772 | \$ | 2,287 | \$ | 8,337 | \$ | 5,963 |

Equity-based compensation is included in operating expenses on the Company's Condensed Consolidated Statements of Income.

## Stock Options

Cash proceeds and intrinsic values related to total stock options exercised during both the three- and nine-month periods ended September 30, 2011 and 2010 are as follows:

|  | Three Months Ended <br> September 30, <br> 2010 |  |  | Nine Months Ended <br> September 30, |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2011 | $\$ 485$ | $\$ 4,005$ | 2010 | $\$ 2,398$ |  |

Intrinsic value of stock $\begin{array}{llllllll}\text { options exercised } & \$ 1,062 & \$ & 808 & \$ & 8,861 & \$, 422\end{array}$

During the three and nine months ended September 30, 2011, approximately 86,000 and 697,000 options vested with a weighted average exercise price of $\$ 24.61$ and $\$ 15.23$, respectively. During the three and nine months ended September 30, 2010, 77,000 and 474,000 options vested with a weighted average exercise price of $\$ 14.97$ and $\$ 10.27$, respectively. As of September 30, 2011, there were $1,948,000$ unvested options with a total of $\$ 10,463$ of unrecognized compensation cost and a weighted average vesting period of 2.5 years. As of September 30, 2010, there were $2,339,000$ unvested options with a total of $\$ 10,752$ of unrecognized compensation cost and a weighted average vesting period of 3.1 years.

The Company estimates the fair value of options granted using the Black-Scholes option-pricing model, which requires several assumptions. The expected term of the options represents the estimated period of time until exercise and is based on the historical experience of similar awards. Expected volatility is based on the historical volatility of the Company's common stock. The risk free interest rate is based on the U.S. Treasury yield curve in effect at the time of the grant. With the exception of a special dividend paid in each of November 2005 and 2006, the Company historically has not paid dividends and thus the expected dividend rate is assumed to be zero. The following weighted average assumptions were used for stock options granted:

## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
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(\$ in thousands except share and per share data)
Note R - Stock-Based Compensation (continued)

| Expected volatility | $47.3 \%$ to $48.7 \%$ | $47.2 \%$ to $52.4 \%$ |
| :--- | :---: | :---: |
| Risk-free interest rate | $0.61 \%$ to $1.78 \%$ | $1.08 \%$ to $2.16 \%$ |
| Expected life (in years) | 2.8 to 4.4 | 2.8 to 4.4 |
| Expected dividend yield | None | None |
| Weighted average fair value | $\$ 10.91$ | $\$ 8.45$ |

Activity relating to stock options granted under the Company's plans during the nine months ended September 30, 2011 is as follows:

|  | Number of Shares | Weighted Average Exercise Price | Weighted <br> Average Remaining Contractual Term | Aggregate <br> Intrinsic <br> Value |
| :---: | :---: | :---: | :---: | :---: |
| Outstanding at January 1, 2011 | 2,703,000 | \$ 14.08 |  |  |
| Granted | 582,000 | 29.80 |  |  |
| Exercised | (357,000 ) | 11.21 |  |  |
| Cancelled/Forfeited | (167,000 ) | 19.30 |  |  |
| Outstanding at September 30, 2011 | 2,761,000 | \$17.45 | 4.8 | \$35,899 |
| Exercisable at September 30, 2011 | 813,000 | \$ 14.25 | 4.2 | \$13,101 |

## Restricted Stock

The following table summarizes restricted stock activity during the nine months ended September 30, 2011 and 2010:

|  | 2011 |  |  |  |
| :--- | :---: | :---: | :---: | :---: |
|  | Weighted <br> Average Fair <br> Value at <br> Grant Date | Number of of <br> Shares | Weighted <br> Average Fair <br> Value at <br> Grant Date |  |
| Shares |  |  |  |  |

As of September 30, 2011, there was $\$ 12,609$ of total unrecognized compensation cost related to restricted stock awards granted under the Plan. This cost is expected to be recognized over a weighted average of 2.9 years. The Company determines the fair value of its restricted stock awards based on the market price of its common stock on the date of grant.

## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
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## Note S - Acquisitions

## Cejon

On May 25, 2011, the Company acquired all of the outstanding shares of capital stock of privately held Cejon, Inc. and Cejon Accessories, Inc. from its sole stockholder as well as all of the outstanding membership interests in New East Designs, LLC (together with Cejon Inc. and Cejon Accessories, "Cejon") from its members (together with the Cejon stockholder, the "Sellers"). Founded in 1991, Cejon markets and sells cold weather accessories, fashion scarves, wraps and other trend accessories primarily under the Cejon brand name, private labels and the Steve Madden brand name. Prior to the acquisition, Cejon had been a licensee of the Company for cold weather and selected other fashion accessories since September 2006. Management believes that Cejon will further strengthen and expand the Company's accessories platform. The acquisition was completed for consideration of $\$ 29,108$ cash plus possible contingent payments pursuant to an earn-out agreement with the Sellers. The earn-out agreement specifies two tiers of potential payments to the Sellers based on the financial performance of Cejon for each of the twelve-month periods ending on June 30, 2012 through 2016, inclusive. The tier one earn-out is based on a graduated percentage of EBITA up to a maximum EBITA of $\$ 11,000$ in each of the earn-out periods, provided that the total aggregate payments under this tier do not exceed $\$ 25,000$. The tier two earn-out is based on a multiple of the amount that EBITA exceeds certain levels in each of the earn-out periods, provided that the total aggregate payments under this tier do not exceed $\$ 33,000$. The fair value of the contingent payments was estimated using the present value of management's projections of the financial results of Cejon during the earn-out period. As of September 30, 2011, the Company estimates the fair value of the contingent consideration to be $\$ 23,500$.

The transaction was accounted for using the acquisition method required by GAAP. Accordingly, the assets and liabilities of Cejon were adjusted to their fair values, and the excess of the purchase price over the fair value of the assets acquired, including identified intangible assets, was recorded as goodwill. The fair values assigned to tangible and intangible assets acquired and liabilities assumed are based on management's estimates and assumptions, which are subject to change. The purchase price has been preliminarily allocated as follows:
$\left.\begin{array}{lc}\text { Accounts receivable } & \$ 3,608 \\ \text { Inventory } & 3,803 \\ \text { Prepaid expenses and other current assets } & 56 \\ \text { Fixed assets } & 292 \\ \text { Trade name } & 27,065 \\ \text { Customer relationships } & 3,225 \\ \text { Non-compete agreement } & 305 \\ \text { Other assets } & 23 \\ \text { Accounts payable } & (1,318\end{array}\right)$

The purchase price and related allocation are preliminary and may be revised as a result of adjustments made to the purchase price as may be required as additional information regarding assets and liabilities is revealed. Contingent consideration classified as a liability will be remeasured at fair value at each reporting date, until the contingency is resolved, with changes recognized in earnings. The goodwill related to this transaction is expected to be deductible for tax purposes over 15 years.

The Company incurred approximately $\$ 517$ in acquisition related costs applicable to the Cejon transaction during the nine-month period ended September 30, 2011. These expenses are included in operating expenses in the Company's Condensed Consolidated Statements of Income.

## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
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(\$ in thousands except share and per share data)

Note S - Acquisitions (continued)
The results of operations of Cejon have been included in the Company's Condensed Consolidated Statements of Income from the date of the acquisition. Unaudited pro forma information related to this acquisition is not included, as the impact of this transaction is not material to the Company's consolidated results.

## Topline

On May 20, 2011, the Company acquired all of the outstanding shares of capital stock of the privately held company, the Topline Corporation ("Topline") from its sole stockholder ("Seller"). Founded in 1980, Topline and its subsidiaries design, manufacture, market and sell private label and branded women's footwear primarily to specialty retailers and department stores. Topline has sourcing capabilities resident in China which include personnel and facilities engaged in direct sourcing. Management believes that Topline is a strategic fit for the Company. The acquisition was completed for consideration of $\$ 56,128$ cash, net of cash acquired, plus possible contingent payments pursuant to an earn-out agreement with the Seller. The earn-out agreement provides for potential payments to the Seller based on the financial performance of Topline for the twelve-month period ending on June 30, 2012. The fair value of the contingent payments was estimated using the present value of management's projections of the financial results of Topline during the earn-out period. As of September 30, 2011, the Company estimates the fair value of the contingent consideration to be $\$ 6,200$.

The transaction was accounted for using the acquisition method required by GAAP. Accordingly, the assets and liabilities of Topline were adjusted to their fair values, and the excess of the purchase price over the fair value of the assets acquired, including identified intangible assets, was recorded as goodwill. The fair values assigned to tangible and intangible assets acquired and liabilities assumed are based on management's estimates and assumptions, which are subject to change. The purchase price has been preliminarily allocated as follows:
Accounts receivable \$55,738

Inventory 8,381
Prepaid expenses and other current assets 857
Fixed assets 2,404
Trade name 16,600
Customer relationships 7,900
Non-compete agreement 300
Other assets 108
Accounts payable (40,612)
Accrued expenses (1,624)
Income tax payable (3,217)
Accrued expenses (3,280 )
Total fair value excluding goodwill 43,555
Goodwill 18,773
Net assets acquired

The purchase price and related allocation is preliminary and may be revised as a result of adjustments made to the purchase price as may be required as additional information regarding assets and liabilities is revealed. Contingent consideration classified as a liability will be remeasured at fair value at each reporting date, until the contingency is resolved, with changes recognized in earnings. The trade name, customer relationships, non-compete agreement and goodwill related to this transaction are not deductible for tax purposes.

The Company incurred approximately $\$ 477$ in acquisition related costs applicable to the Topline transaction during the period ended September 30, 2011. These expenses are included in operating expenses in the Company's Condensed Consolidated Statements of Income.

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
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(\$ in thousands except share and per share data)
Note S - Acquisitions (continued)
The results of operations of Topline have been included in the Company's Condensed Consolidated Statements of Income from the date of the acquisition. Unaudited pro forma information related to this acquisition is not included, as the impact of this transaction is not material to the Company's consolidated results.

Betsey Johnson intellectual property
On October 5, 2010, pursuant to a Restructuring Agreement between the Company and Betsey Johnson LLC ("Betsey Johnson"), the Company acquired all right, title and interest in substantially all of the intellectual property of Betsey Johnson, including, among other things, the Betsey Johnson® and Betseyville ${ }^{\circledR}$ trademarks, and certain intellectual property licenses and other contracts, including the right to receive royalties and other income with respect thereto (the "Betsey Johnson Assets"). In connection with the transaction, the Company also received a $10 \%$, non-voting membership interest in Betsey Johnson. Management believes that the Betsey Johnson Assets offer meaningful growth opportunity for the Company. Prior to the acquisition, Betsey Johnson had licensed to the Company the right to use the Betsey Johnson® and Betseyville ${ }^{\circledR}$ trademarks in connection with the sale and marketing of handbags, small leather goods, belts and umbrellas. The acquisition of the Betsey Johnson Assets was the culmination of a series of transactions. First, in August 2010, the Company purchased from various members of a loan syndicate their respective participations in a term loan in the aggregate outstanding principal amount of $\$ 48,750$ (the "Loan") made by the syndicate lenders to Betsey Johnson. The Company paid the syndicate lenders an aggregate purchase price of $\$ 29,217$, including transaction costs, for their participations in the Loan. The Loan was secured by a first priority security interest in substantially all of the assets of Betsey Johnson and was in default on the date of purchase. On October 5, 2010, the Company entered into the Restructuring Agreement with Betsey Johnson, pursuant to which, in consideration of the elimination of all amounts owed with respect to the Loan, the Company acquired the Betsey Johnson Assets. The Company believes that Betsey Johnson® is a well known, iconic brand and thus the trademark is an indefinite lived asset. As such, the $\$ 29,217$ purchase price for the Betsey Johnson intellectual property will not be amortized, rather, it will be tested for impairment on an annual basis or more often if events or circumstances change that could cause the Betsey Johnson intellectual property to become impaired. The Company made a new secured term loan to Betsey Johnson on October 5, 2010 in the principal amount of $\$ 3,000$, which accrues interest at the rate of $8 \%$ per annum and becomes due on December 31, 2015. As of September 30, 2011, $\$ 244$ of interest has accrued on the note and has been reflected on the Company's Condensed Consolidated Financial Statements. The new term loan is secured by a first priority security interest in substantially all of the remaining properties and assets of Betsey Johnson.

## Big Buddha

On February 10, 2010, the Company acquired all of the outstanding shares of stock of privately held Big Buddha, Inc. ("Big Buddha") from its sole stockholder ("Seller"). Founded in 2003, Big Buddha designs and markets fashion-forward handbags to specialty retailers and better department stores. Management believes that Big Buddha is a strategic fit for the Company. The acquisition was completed for consideration of $\$ 11,119$ in cash, net of cash acquired, plus contingent payments pursuant to an earn-out agreement with the Seller. The earn-out agreement provides for potential payments to the Seller based on the financial performance of Big Buddha handbags for each of the twelve-month periods ending on March 31, 2011, 2012 and 2013. The fair value of the contingent payments was estimated using the present value of management's projections of the financial results of Big Buddha during the earn-out period. The

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Company estimated the fair value of the contingent consideration to be $\$ 14,000$. The earn-out payment for the twelve-month period ended March 31, 2011 was $\$ 3,603$.

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
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(\$ in thousands except share and per share data)
Note S - Acquisitions (continued)
The transaction was accounted for using the acquisition method required by GAAP. Accordingly, the assets and liabilities of Big Buddha were adjusted to their fair values, and the excess of the purchase price over the fair value of the assets acquired, including identified intangible assets, was recorded as goodwill. The fair values assigned to tangible and intangible assets acquired and liabilities assumed are based on management's estimates and assumptions, which are subject to change. The purchase price has been allocated as follows:
Accounts receivable \$668
Inventory 1,212

Prepaid expenses and other current assets 102
Trade name 4,100
Customer relationships $\quad 4,900$
Non-compete agreement 450
Accounts payable (171
Accrued expenses (442)
Total fair value excluding goodwill $\quad 10,819$
Goodwill 14,300
Net assets acquired \$25,119

Contingent consideration classified as a liability will be remeasured at fair value at each reporting date, until the contingency is resolved, with changes recognized in earnings. The goodwill related to this transaction is expected to be deductible for tax purposes over 15 years.

The Company incurred approximately $\$ 430$ in acquisition related costs applicable to the Big Buddha transaction during the six-month period ended June 30, 2010. These expenses are included in operating expenses in the Company's Condensed Consolidated Statements of Income.

The results of operations of Big Buddha have been included in the Company's Condensed Consolidated Statements of Income from the date of the acquisition. Unaudited pro forma information related to this acquisition is not included, as the impact of this transaction is not material to the Company's consolidated results.

Note T - Consolidated Variable Interest entity
On April 15, 2011, the Company formed a joint venture with two individuals through a limited liability company, Madlove, LLC ("Madlove"), as to which the Company is the primary beneficiary. Madlove designs and markets women's footwear under the Madlove label. As the primary beneficiary of Madlove, the assets, liabilities and results of operations of Madlove are included in the Company's Condensed Consolidated Financial Statements. The other members' interests are reflected in "Net loss attributable to noncontrolling interests" in the Condensed Consolidated Statements of Income and "Noncontrolling interests" in the Condensed Consolidated Balance Sheets. The following table summarizes the carrying amount of Madlove's assets and liabilities included in the Company's Condensed

Consolidated Balance Sheets at September 30, 2011:

| Accounts receivable - net | $\$ 277$ |
| :--- | :---: |
| Inventory | 93 |
| Fixed assets - net | 43 |
| Current assets | 413 |
|  |  |
| Due to Steven Madden, Ltd. | 17 |
| Other current liabilities | 147 |
| Current liabilities | $\$ 164$ |

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
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(\$ in thousands except share and per share data)
Note U-Goodwill and Intangible Assets
The following is a summary of the carrying amount of goodwill by segment for the nine months ended September 30, 2011:

|  | Wholesale |  |  | Net Carrying <br> Amount |
| :--- | :---: | :---: | :---: | :---: | :---: |
|  | Footwear | Accessories | Retail |  |
| Balance at January 1, 2011 | $\$ 1,547$ | $\$ 31,565$ | $\$ 5,501$ | $\$ 38,613$ |
| Acquisition of Cejon | - | 17,590 | - | 17,590 |
| Acquisition of Topline | 18,773 | - | - | 18,773 |
| Balance at September 30, 2011 | $\$ 20,320$ | $\$ 49,155$ | $\$ 5,501$ | $\$ 74,976$ |

The following table details identifiable intangible assets as of September 30, 2011:

|  | Estimated Lives | Cost Basis |  | Accumulated Amortization |  | Net Carrying Amount |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Trade names | 6-10 years | \$ | 4,591 | \$ | 1,062 | \$ | 3,529 |
| Customer relationships | 10 years |  | 22,834 |  | 4,428 |  | 18,406 |
| License agreements | 3-6 years |  | 5,600 |  | 5,469 |  | 131 |
| Non-compete agreement | 5 years |  | 1,985 |  | 1,113 |  | 872 |
| Other | 3 years |  | 14 |  | 14 |  | - |
|  |  |  | 35,024 |  | 12,086 |  | 22,938 |
| Trademarks | indefinite |  | 72,842 |  | - |  | 72,842 |
|  |  | \$ | 107,866 | \$ | 12,086 | \$ | 95,780 |

The estimated future amortization expense of purchased intangibles as of September 30, 2011 is as follows:

| 2011 (remaining three months) | $\$ 913$ |
| :--- | :---: |
| 2012 | 2,993 |
| 2013 | 2,993 |
| 2014 | 2,926 |
| 2015 | 2,742 |
| Thereafter | 10,371 |

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)
Note V-Comprehensive Income
The following table displays comprehensive income for the three and nine months ended September 30, 2011 and 2010:

|  | Three Months Ended September 30, |  |  |  | Nine Months Ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2011 |  | 2010 |  | 2011 |  | 2010 |  |
| Net income | \$ | 31,868 | \$ | 22,916 | \$ | 73,415 | \$ | 58,100 |
| Unrealized gains (losses) on marketable securities |  | (644 |  | 1,090 |  | (232 |  | 1,746 |
| Comprehensive income, net of income taxes |  | 31,224 |  | 24,006 |  | 73,183 |  | 59,846 |
| Comprehensive loss attributable to the noncontrolling interest |  | 43 |  | - |  | 132 |  | - |
| Comprehensive net income attributable to Steven Madden, Ltd. | \$ | 31,267 | \$ | 24,006 | \$ | 73,315 | \$ | 59,846 |

Note W - Commitments, Contingencies and Other
Legal proceedings:
(a) On June 24, 2009, a class action lawsuit, Shahrzad Tahvilian, et al. v. Steve Madden Retail, Inc. and Steve Madden, Ltd., Case No. BC 414217, was filed in the Superior Court of California, Los Angeles County, against the Company and its wholly-owned subsidiary alleging violations of California labor laws. The parties submitted the dispute to private mediation and, on August 31, 2010, reached a settlement on all claims. Based on the proposed settlement, the Company increased its reserve for this claim from $\$ 1,000$ to $\$ 2,750$ in the third quarter of 2010. In June 2011, the court approved the final settlement for $\$ 1,968$. The payment of the final settlement did not have a material effect on the Company's financial position.
(b) On August 10, 2005, following the conclusion of an audit of the Company conducted by auditors for U.S. Customs and Border Protection ("U.S. Customs") during 2004 and 2005, U.S. Customs issued a report that asserts that certain commissions that the Company treated as "buying agents' commissions" (which are non-dutiable) should be treated as "selling agents' commissions" and hence are dutiable. Subsequently, U.S. Immigration and Customs Enforcement notified the Company's legal counsel that a formal investigation of the Company's importing practices had been commenced as a result of the audit. In September of 2007, U.S. Customs notified the Company that it had finalized its assessment of the underpaid duties at $\$ 1,400$. The Company, with the advice of legal counsel, evaluated the liability in the case, including additional duties, interest and penalties, and believed that it was not
likely to exceed $\$ 3,045$, and accordingly, a reserve for this amount was recorded as of December 31, 2009. The Company contested the conclusions of the U.S. Customs audit and filed a request for review and issuance of rulings thereon by U.S. Customs Headquarters, Office of Regulations and Rulings, under internal advice procedures. On September 20, 2010, the Company was advised by legal counsel that U.S. Customs had issued a ruling in the matter, concluding that the commissions paid by the Company pursuant to buying agreements entered into by the Company and one of its two buying agents under review were bona fide buying-agent commissions and, therefore, were non-dutiable. With respect to the second buying agent, U.S. Customs also ruled that beginning in February of 2002, commissions paid by the Company were bona fide buying agent commissions and, therefore, were non-dutiable. However, U.S. Customs found that the Company's pre-2002 buying agreements with the second agent were legally insufficient to substantiate a buyer-buyer's agent relationship between the Company and the agent and that commissions paid to the second agent under such buying agreements, in fact, were dutiable. The Company is reviewing the ruling, its consequences and the Company's options with its legal counsel. On the basis of the U.S. Customs ruling, the Company reevaluated the liability in the case and believes that it is not likely to exceed $\$ 1,248$ and the reserve was reduced from $\$ 3,045$ to such amount as of September 30, 2010.

## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)
Note W - Commitments, Contingencies and Other (continued)


#### Abstract

U.S. Customs has not made a formal claim for collection of the duties allegedly owed and, as the statute of limitations for commencement of a collection claim is expiring, U.S. Customs has requested a waiver from the Company of the statue of limitations until December 5, 2013. The Company has submitted a proposed waiver of the statute of limitations to U. S. Customs in this regard the terms of which have not yet been agreed upon. If the Company and U. S. Customs do not reach agreement regarding the terms of the waiver, the statute of limitations for the commencement of a collection action will expire on December 5, 2011. (c) The Company has been named as a defendant in certain other lawsuits in the normal course of business. In the opinion of management, after consulting with legal counsel, the liabilities, if any, resulting from these matters should not have a material effect on the Company's financial position or results of operations. It is the policy of management to disclose the amount or range of reasonably possible losses in excess of recorded amounts.


Note X- Operating Segment Information
The Company operates the following business segments: Wholesale Footwear, Wholesale Accessories, Retail, First Cost and Licensing. The Wholesale Footwear segment, through sales to department stores, mid-tier retailers and specialty stores worldwide, derives revenue from sales of branded and private label women's, men's, girls' and children's footwear. The Wholesale Accessories segment, which includes branded and private label handbags, belts and small leather goods as well as cold weather and selected other fashion accessories, derives revenue from sales to department, mid-tier and specialty stores worldwide. The Retail segment, through the operation of Company owned retail stores and the Company's website, derives revenue from sales of branded women's, men's and children's footwear, accessories and licensed products to consumers. The First Cost segment represents activities of a subsidiary which earns commissions for serving as a buying agent of footwear products to mass-market merchandisers, mid-tier department stores and other retailers with respect to their purchase of footwear. In the Licensing segment, the Company licenses its Steve Madden ${ }^{\circledR}$ and Steven by Steve Madden® trademarks for use in connection with the manufacture, marketing and sale of sunglasses, eyewear, outerwear, bedding, hosiery and women's fashion apparel and jewelry. The Company licenses the Big Buddha® brand for use in connection with the manufacture, marketing and sale of sunglasses and cold weather accessories. In addition, the Company licenses the Betsey Johnson® and Betseyville® trademarks for use in connection with the manufacture, marketing and sale of apparel, jewelry, lingerie, swimwear, eyewear, watches and outerwear.

## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)
Note X - Operating Segment Information (continued)

| As of and three months ended, | Wholesale Footwear |  | Wholesale Accessories |  | Total Wholesale |  | Retail |  | First Cost |  | Licensing |  | Consolidated |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| September 30, 2011: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net sales to external customers |  | 211,223 | \$ | 67,030 | \$ | 278,253 | \$ | 35,634 |  |  |  |  | \$ | 313,887 |
| Gross profit |  | 66,652 |  | 21,973 |  | 88,625 |  | 20,828 |  |  |  |  |  | 109,453 |
| Commissions and licensing fees - net |  | - |  | - |  | - |  | - | \$ | 3,318 | \$ | 2,331 |  | 5,649 |
| Income from operations |  | 31,616 |  | 10,974 |  | 42,590 |  | 2,269 |  | 3,318 |  | 2,331 |  | 50,508 |
| Segment assets | \$ | 374,329 | \$ | 157,369 |  | 531,698 |  | 69,242 |  | 50,074 |  | - |  | 651,014 |
| Capital expenditures |  |  |  |  |  | 4,558 | \$ | 1,715 | \$ | - |  | - |  | 6,273 |

September 30,
2010:

| Net sales to external customers | \$ | 123,251 | \$ | 29,801 | \$ | 153,052 | \$ | 31,066 |  |  |  |  | \$ | 184,118 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Gross profit |  | 48,362 |  | 11,095 |  | 59,457 |  | 18,051 |  |  |  |  |  | 77,508 |
| Commissions and licensing fees - net |  | - |  | - |  | - |  | - | \$ | 5,617 | \$ | 970 |  | 6,587 |
| Income (loss) from operations |  | 27,503 |  | 5,043 |  | 32,546 |  | (1,745 |  | 5,617 |  | 970 |  | 37,388 |
| Segment assets | \$ | 302,842 | \$ | 72,078 |  | 374,920 |  | 42,964 |  | 12,130 |  | - |  | 430,014 |
| Capital expenditures |  |  |  |  | \$ | 337 | \$ | 711 | \$ | - | \$ | - | \$ | 1,048 |



Capital
expenditures
September 30, 2010:
Net sales to external

| customers | \$ | 310,176 | \$ | 75,161 | \$ | 385,337 | \$ | 89,053 |  |  |  |  | \$ | 474,390 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Gross profit |  | 123,929 |  | 29,308 |  | 153,237 |  | 53,057 |  |  |  |  |  | 206,294 |
| Commissions and licensing fees - net |  | - |  | - |  | - |  | - | \$ | 14,976 | \$ | 3,024 |  | 18,000 |
| Income (loss) from operations |  | 65,045 |  | 12,169 |  | 77,214 |  | (914 | ) | 14,976 |  | 3,024 |  | 94,300 |
| Segment assets | \$ | 302,842 | \$ | 72,078 |  | 374,920 |  | 42,964 |  | 12,130 |  | - |  | 430,014 |
| Capital expenditures |  |  |  |  | \$ | 814 | \$ | 1,466 | \$ | - | \$ | - | \$ | 2,280 |

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited
September 30, 2011
(\$ in thousands except share and per share data)
Note X - Operating Segment Information (continued)
Revenues by geographic area for the three- and nine-month periods ended September 30 are as follows:

|  | Three months ended |  | Nine months ended |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  | September 30, |  |  | September 30, |  |  |  |
|  | 2011 | 2010 |  | 2011 | 2010 |  |  |
|  | $\$$ | 297,873 | $\$$ | 172,334 | $\$$ | 650,408 | $\$$ |
| Domestic |  | 16,014 |  | 11,784 |  | 38,386 |  |
| International | $\$$ | 313,887 | $\$$ | 184,118 | $\$$ | 688,794 | $\$$ |
| Total |  |  |  |  |  | 474,390 |  |

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## ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes thereto appearing elsewhere in this Quarterly Report.

This Quarterly Report contains certain forward-looking statements as that term is defined in the federal securities laws. The events described in forward-looking statements contained in this Quarterly Report may not occur. Generally forward-looking statements relate to business plans or strategies, projected or anticipated benefits or other consequences of our plans or strategies, projected or anticipated benefits from acquisitions to be made by us, or projections involving anticipated revenues, earnings or other aspects of our operating results. The words "may", "will", "expect", "believe", "anticipate", "project", "plan", "intend", "estimate", and "continue", and their opposites and similar expre intended to identify forward-looking statements. We caution you that these statements are not guarantees of future performance or events and are subject to a number of uncertainties, risks and other influences, many of which are beyond our control, that may influence the accuracy of the statements and the projections upon which the statements are based. Factors that may affect our results include, but are not limited to, the risks and uncertainties discussed in our Annual Report on Form 10-K for the year ended December 31, 2010. Any one or more of these uncertainties, risks and other influences could materially affect our results of operations and whether forward-looking statements made by us ultimately prove to be accurate. Our actual results, performance and achievements could differ materially from those expressed or implied in these forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether from new information, future events or otherwise.

## Overview:

(\$ in thousands, except retail sales data per square foot and earnings per share)
Steven Madden, Ltd. and its subsidiaries (collectively, the "Company") designs, sources, markets and sells fashion-forward footwear, handbags and accessories for women, men and children. We distribute products through department stores, specialty stores, luxury retailers, national chains, mass merchants, our retail stores and our e-commerce website throughout the United States as well as through special distribution arrangements in Canada, Europe, Central and South America, Australia, India and Asia. Our product line includes a broad range of updated styles which are designed to establish or capitalize on market trends, complemented by core products. We have established a reputation for our creative designs, popular styles and quality products at affordable price points. The Company licenses its Steve Madden®, Steven by Steve Madden®, Big Buddha and Betsey Johnson® marks for use in connection with the manufacture, marketing and sale of various product lines including sunglasses, eyewear, outerwear, bedding, hosiery, women's fashion apparel, lingerie, swimwear, and jewelry

On May 5, 2011, the Company's Board of Directors announced a three-for-two stock split of the Company's outstanding shares of common stock, effected in the form of a stock dividend on the Company's outstanding common stock. Stockholders of record at the close of business on May 20, 2011 received one additional share of Steven Madden, Ltd. common stock for every two shares of common stock owned on this date. The additional shares were distributed on May 31, 2011. Stockholders received cash in lieu of any fractional shares of common stock they otherwise would have received in connection with the dividend. All share and per share data provided herein gives effect to this stock split, applied retroactively.

As we move towards fulfilling our stated goal of expanding our demographic reach, there have been several changes to our business that should be considered when comparing our year over year results. Our recently acquired Topline and Cejon businesses contributed incremental sales of $\$ 81,732$ in the third quarter of 2011. Cejon derives its revenues
from the sale of cold weather accessories, fashion scarves, wraps and other trend accessories, and thus most of its business is heavily geared towards the second half of the year. As a result, Cejon's receivables, payables and inventory levels are inordinately high at the end of the third quarter. We continue to pursue growth opportunities in our international business, and as a result, our international sales increased 36\% in the quarter ended September 30, 2011. During the third quarter of 2011, the transition of our Target private label business from the commission model to the wholesale model caused net sales to increase by $\$ 25,111$.

We achieved the highest quarterly sales and earnings results in the Company's history during the third quarter of 2011. Net sales for the three months ended September 30, 2011 increased to $\$ 313,887$ compared to $\$ 184,118$ in the same period of last year. Excluding net sales derived from Topline and Cejon, both acquired in May of 2011, as well as the Target and Olsenboye footwear businesses, which were not included in the net sales line last year, organic net sales growth was $11.7 \%$ on a consolidated basis. Net income increased $39 \%$ in the third quarter of this year to $\$ 31,868$, compared with $\$ 22,916$ in the same period last year. Diluted earnings per share for the third quarter of 2011 increased $37 \%$ to $\$ 0.74$ per share on $43,407,000$ diluted weighted average shares outstanding compared to $\$ 0.54$ per share on $42,353,000$ diluted weighted average shares outstanding in the third quarter of last year.

In our Retail segment, same store sales (sales of those stores, including the e-commerce website, that were in operation throughout the third quarters of 2011 and 2010) increased 13.2\%. As of September 30, 2011 we had 82 stores in operation, which is flat to last year. During the twelve months ended September 30, 2011, sales per square foot was $\$ 792$ compared to $\$ 710$ achieved in the same period of 2010.

Our annualized inventory turnover was 9.5 in the third quarter of 2011 and was 9.7 times in the third quarter of 2010. Our accounts receivable average days outstanding was 62 days in the third quarter of 2011 compared to 55 days in the third quarter of the previous year. As of September 30, 2011, we had $\$ 111,800$ in cash, cash equivalents and marketable securities, no short- or long-term debt, and total stockholders' equity of $\$ 447,001$. As of September 30, 2011 working capital increased to $\$ 197,553$ compared to $\$ 130,749$ on September 30, 2010.

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The following tables set forth certain selected financial information relating to results of operations for the periods indicated:

Selected Financial Information
Three Months Ended
September 30,
(\$ in thousands)
2011
2010
CONSOLIDATED:

| Net sales | $\$$ | 313,887 | 100 | $\%$ | $\$$ | 184,118 | 100 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Cost of sales | 204,434 | 65 |  | 106,610 | 58 |  |  |
| Gross profit | 109,453 | 35 |  | 77,508 | 42 |  |  |
| Other operating income - net of expenses | 5,649 | 2 |  | 6,587 | 4 |  |  |
| Operating expenses | 64,594 | 21 |  | 46,707 | 25 |  |  |
| Income from operations | 50,508 | 16 |  | 37,388 | 20 |  |  |
| Interest and other income, net | 1,732 | 1 | 1,201 | 1 |  |  |  |
| Income before income taxes | 52,240 | 17 |  | 38,589 | 21 |  |  |
| Net income | 31,868 | 10 | 22,916 | 12 |  |  |  |

By Segment:
WHOLESALE FOOTWEAR
SEGMENT:

| Net sales | $\$$ | 211,223 | 100 | $\%$ | $\$$ | 123,251 | 100 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Cost of sales | 144,571 | 68 |  | 74,889 | 61 |  |  |
| Gross profit | 66,652 | 32 |  | 48,362 | 39 |  |  |
| Operating expenses | 35,036 | 17 |  | 20,859 | 17 |  |  |
| Income from operations | 31,616 | 15 |  | 27,503 | 22 |  |  |

## WHOLESALE ACCESSORIES

SEGMENT:

| Net sales | $\$$ | 67,030 | 100 | $\%$ | $\$$ | 29,801 | 100 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Cost of sales | 45,057 | 67 |  | 18,706 | 63 |  |  |
| Gross profit | 21,973 | 33 |  | 11,095 | 37 |  |  |
| Operating expenses | 10,999 | 16 |  | 6,052 | 20 |  |  |
| Income from operations | 10,974 | 16 |  | 5,043 | 17 |  |  |

RETAIL SEGMENT:

| Net sales | $\$$ | 35,634 | 100 | $\%$ | $\$$ | 31,066 | 100 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Cost of sales | 14,806 | 42 |  | 13,015 | 42 |  |  |
| Gross profit | 20,828 | 58 |  | 18,051 | 58 |  |  |
| Operating expenses | 18,559 | 52 |  | 19,796 |  | 64 |  |
| Income (loss) from operations | 2,269 | 6 | $(1,745$ | $)$ | $(6$ | $)$ |  |
| Number of stores | 82 |  | 82 |  |  |  |  |

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FIRST COST SEGMENT:


## LICENSING SEGMENT:

$\begin{array}{lllllllll}\text { Licensing income }- \text { net of expenses } & \$ & 2,331 & 100 & \% & \$ & 970 & 100 & \%\end{array}$

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Selected Financial Information<br>Nine Months Ended<br>September 30<br>(\$ in thousands)

## CONSOLIDATED:

| Net sales | $\$$ | 688,794 | 100 | $\%$ | $\$$ | 474,390 | 100 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Cost of sales | 426,114 | 62 |  | 268,096 | 57 |  |  |  |
| Gross profit | 262,680 | 38 |  | 206,294 | 43 |  |  |  |
| Other operating income - net of expenses |  | 14,648 | 2 |  | 18,000 | 4 |  |  |
| Operating expenses | 162,177 | 24 |  | 129,994 | 27 |  |  |  |
| Income from operations | 115,151 | 17 |  | 94,300 | 20 |  |  |  |
| Interest and other income - net | 4,905 | 1 |  | 2,927 | 1 |  |  |  |
| Income before income taxes | 120,056 | 17 |  | 97,227 | 20 |  |  |  |
| Net income | 73,415 | 11 |  | 58,100 | 12 |  |  |  |

By Segment:

## WHOLESALE FOOTWEAR SEGMENT:

| Net sales | $\$$ | 468,204 | 100 | $\%$ | $\$$ | 310,176 | 100 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Cost of sales | 308,889 | 66 |  | 186,247 | 60 |  |  |  |
| Gross profit | 159,315 | 34 |  |  | 123,929 | 40 |  |  |
| Operating expenses |  | 85,602 | 18 |  | 58,884 | 19 |  |  |
| Income from operations | 73,713 | 16 |  | 65,045 | 21 |  |  |  |

## WHOLESALE ACCESSORIES SEGMENT:

| Net sales | $\$$ | 119,480 | 100 | $\%$ | $\$$ | 75,161 | 100 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Cost of sales | 77,267 | 65 |  |  | 45,853 | 61 |  |  |
| Gross profit | 42,213 | 35 |  | 29,308 | 39 |  |  |  |
| Operating expenses | 23,593 | 20 |  |  | 17,139 | 23 |  |  |
| Income from operations | 18,620 | 16 |  | 12,169 | 16 |  |  |  |

## RETAIL SEGMENT:

| Net sales | $\$$ | 101,110 | 100 | $\%$ | $\$$ | 89,053 | 100 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Cost of sales | 39,958 | 40 |  | 35,996 | 40 |  |  |  |
| Gross profit | 61,152 | 60 |  | 53,057 | 60 |  |  |  |
| Operating expenses | 52,982 | 52 |  | 53,973 | 61 |  |  |  |
| Income (loss) from operations | 8,170 | 8 |  | $(914$ | $)$ | $(1$ | $)$ |  |
| Number of stores | 82 |  | 82 |  |  |  |  |  |

FIRST COST SEGMENT:
$\begin{array}{llllllllll}\text { Other commission income }- \text { net of expenses } & \$ & 8,605 & 100 & \% & \$ & 14,976 & 100 & \%\end{array}$

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## LICENSING SEGMENT:

| Licensing income - net of expenses | $\$$ | 6,043 | 100 | $\%$ | $\$$ | 3,024 | 100 | $\%$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

## RESULTS OF OPERATIONS

(\$ in thousands)
Three Months Ended September 30, 2011 Compared to Three Months Ended September 30, 2010

## Consolidated:

Net sales for the three months ended September 30, 2011 increased to $\$ 313,887$ compared to $\$ 184,118$ for the comparable period of 2010. Excluding net sales from Topline and Cejon, both acquired in May of 2011, as well as the Target and Olsenboye footwear businesses, which were not included in the net sales line last year, organic net sales growth was $11.7 \%$ on a consolidated basis. Our gross margin was $34.9 \%$ for the third quarter of 2011 compared to $42.1 \%$ in the comparable period of 2010 , with the decrease due to sales mix shifts as a result of the addition of the Topline and Cejon businesses and the inclusion of the Company's Target private label and Olsenboye footwear businesses in net sales. Excluding these businesses, consolidated gross margin was flat to prior year's third quarter. Operating expenses increased in the third quarter of this year to $\$ 64,594$ from $\$ 46,707$ in the same period last year, primarily due to incremental costs associated with our recently acquired Topline and Cejon businesses and our new Betsey Johnson® and Big Buddha ${ }^{\circledR}$ shoe businesses. As a percentage of sales, exclusive of Topline and Cejon, operating expenses decreased to $20.6 \%$ in the third quarter of 2011 from $25.4 \%$ in the same period of last year, reflecting leverage gained from sales increases. Our commission and licensing fee income decreased to $\$ 5,649$ in the third quarter of 2011 compared to $\$ 6,587$ in the third quarter of 2010 due to the transition of our Target private label and Olsenboye footwear businesses from the commission model to the wholesale model. Net income for the third quarter of 2011 increased $39 \%$ to $\$ 31,868$ compared to net income for the quarter ended September 30, 2010 of \$22,916.

## Wholesale Footwear Segment:

Net sales from the Wholesale Footwear segment accounted for $\$ 211,223$ or $67 \%$ and $\$ 123,251$ or $67 \%$ of our total net sales for the third quarter of 2011 and 2010, respectively. The $71 \%$ increase in net sales quarter over quarter was partially due to the inclusion of net sales from our Topline, Target and Olsenboye businesses, none of which were included in the net sales line last year. In addition, nets sales increased due to organic growth in our Steve Madden Women's, Madden Girl and Steven brands as well as in our international business. Finally, two new brands, Big Buddha ${ }^{\circledR}$ shoes, which began shipping in the third quarter of 2010, and Betsey Johnson ${ }^{\circledR}$ shoes, which began shipping in the first quarter of 2011, also contributed to the increase in net sales.

Gross profit margin in the Wholesale Footwear segment was $31.6 \%$ in the third quarter of 2011 and was $39.2 \%$ in the same period last year. This decrease was due to sales mix shifts as a result of the addition of the Topline business and the inclusion of the Company's Target private label and Olsenboye footwear businesses in net sales. In the third quarter of 2011 , operating expenses increased to $\$ 35,036$ from $\$ 20,859$ in the third quarter last year, primarily due to incremental costs associated with our recently acquired Topline business and our new Betsey Johnson® and Big Buddha ${ }^{\circledR}$ shoe businesses. As a percentage of sales, operating expenses decreased to $16.6 \%$ in the third quarter of 2011 compared to $16.9 \%$ in the same quarter of last year. Income from operations for the Wholesale Footwear segment increased to $\$ 31,616$ for the quarter ended September 30, 2011 compared to $\$ 27,503$ for the same period of last year.

## Wholesale Accessories Segment:

Net sales generated by the Wholesale Accessories segment accounted for $\$ 67,030$ or $21 \%$ and $\$ 29,801$ or $16 \%$ of total Company net sales for the third quarters of 2011 and 2010, respectively. The $125 \%$ increase in net sales quarter over quarter was primarily due to our recently acquired Cejon business, which contributed $\$ 32,620$ in net sales in the third
quarter of 2011. In addition, double digit net sales increases in our Steven Madden, Big Buddha and Betsey Johnson handbag businesses also contributed to our net sales increase for the quarter.

Gross profit margin in the Wholesale Accessories segment was $32.8 \%$ in the third quarter of this year and $37.2 \%$ in the same period last year. This decrease was primarily due to the addition of our Cejon cold weather accessories business which typically achieves lower gross margins than our existing handbag and belt businesses. In the third quarter of 2011 , operating expenses increased to $\$ 10,999$ compared to $\$ 6,052$ in the same quarter of the prior year, primarily due to the incremental costs related to our recently acquired Cejon business. As a percentage of sales, operating expenses decreased 390 basis points to $16.4 \%$ in the third quarter of 2011 compared to $20.3 \%$ in the same quarter of last year, reflecting leverage from increased sales. Income from operations for the Wholesale Accessories segment increased to $\$ 10,974$ for the quarter ended September 30, 2011, compared to $\$ 5,043$ for the quarter ended September 30, 2010.

## Retail Segment:

In the third quarter of 2011, net sales from the Retail segment accounted for $\$ 35,634$ or $11 \%$ of our total net sales compared to $\$ 31,066$ or $17 \%$ of total net sales in the same period last year. We opened eight new stores, acquired one store as part of the acquisition of Topline and closed nine under-performing stores during the twelve months ended September 30, 2011. As a result, we had 82 retail stores as of September 30, 2011 and 2010. The 82 stores currently in operation include 72 Steve Madden full price stores, five Steve Madden outlet stores, three Steven stores, one Report store and one e-commerce website. Comparable store sales (sales of those stores, including the e-commerce website, that were open throughout the third quarters of 2011 and 2010) increased $13.2 \%$ in the third quarter of this year. In the quarter ended September 30, 2011, gross margin increased to $58.4 \%$ from $58.1 \%$ in the same period of 2010, primarily due to a decrease in promotional selling combined with improved operating efficiencies. In the third quarter of 2011, operating expenses were $\$ 18,559$ compared to $\$ 19,796$ in the third quarter of last year. The decrease in operating expenses was due to a charge of $\$ 1,750$ in the third quarter of 2010 for the preliminary settlement of a class action lawsuit (see Note W to the Condensed Consolidated Financial Statements). Income from operations for the Retail segment increased to $\$ 2,269$ in the third quarter of this year compared to a loss from operations of $\$ 1,745$ in the same period of last year.

## First Cost Segment:

The First Cost segment generated net commission income and design fees of $\$ 3,318$ for the three-month period ended September 30, 2011, compared to $\$ 5,617$ for the comparable period of 2010. The primary reason for this decrease is the transition of our Target private label and Olsenboye footwear businesses from the commission model to the wholesale model in 2011.

## Licensing Segment:

During the quarter ended September 30, 2011, net licensing income increased to $\$ 2,331$ from $\$ 970$ in the same period of last year primarily due to the incremental licensing revenue generated by our recently acquired Betsey Johnson intellectual property assets.

Nine Months Ended September 30, 2011 Compared to Nine Months Ended September 30, 2010

## Consolidated:

Total net sales for the nine-month period ended September 30, 2011 increased by $45 \%$ to $\$ 688,794$ from $\$ 474,390$ for the comparable period of 2010. During the nine months ended September 30, 2011, gross margin decreased to $38.1 \%$ compared to $43.5 \%$ in the same period of last year. Operating expenses increased in the nine months ended September 30 , 2011 to $\$ 162,177$ from $\$ 129,994$ in the same period last year, primarily due to incremental costs associated with our recently acquired Topline and Cejon businesses and our new Betsey Johnson® and Big Buddha ${ }^{\circledR}$ shoe businesses. As a percentage of sales, operating expenses decreased 390 basis points to $23.5 \%$ in the nine months ended September 30,2011 compared to $27.4 \%$ in the same period of last year. Commission and licensing fee income decreased to $\$ 14,648$ in the first nine months of 2011 compared to $\$ 18,000$ in the first nine months of 2010 . During the nine months ended September 30, 2011, income from operations increased $22 \%$ to $\$ 115,151$ and net income increased $26 \%$ to $\$ 73,415$ compared to income from operations of $\$ 94,300$ and a net income of $\$ 58,100$ in the same period last year.

Wholesale Footwear Segment:
Net sales from the Wholesale Footwear segment accounted for $\$ 468,204$ or $68 \%$ and $\$ 310,176$ or $65 \%$ of our total net sales for the first nine months of 2011 and 2010, respectively. The $51 \%$ increase in net sales period over period was
partially due to the inclusion of net sales from our Topline, Target and Olsenboye businesses, none of which were included in the net sales line last year. In addition, organic growth in our Steve Madden Women's and Madden Girl as well as a $51 \%$ sales increase in our international business contributed to our net sales increase in the third quarter of 2011. Finally, two new brands, Big Buddha® shoes, which began shipping in the third quarter of 2010, and Betsey Johnson® shoes, which began shipping in the first quarter of 2011, also contributed to the increase in net sales.

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Gross profit margin decreased to $34.0 \%$ in the first nine months of this year from $40.0 \%$ in the same period last year, due to sales mix shifts as a result of the addition of the Topline business and the inclusion of the Company's Target private label and Olsenboye footwear businesses in net sales. In the first nine months of 2011, operating expenses increased to $\$ 85,602$ from $\$ 58,884$ in the same period of 2010 , primarily due to incremental costs associated with our recently acquired Topline business and our new Betsey Johnson ${ }^{\circledR}$ and Big Buddha ${ }^{\circledR}$ shoe businesses. As a percentage of sales, operating expenses improved to $18.3 \%$ in the first nine months of 2011 from $19.0 \%$ in the same period of last year. Income from operations for the Wholesale Footwear Segment increased to $\$ 73,713$ for the nine-month period ended September 30, 2011 compared to $\$ 65,045$ for the same period of 2010.

## Wholesale Accessories Segment:

Net sales generated by the Wholesale Accessories segment accounted for $\$ 119,480$ or $17 \%$ and $\$ 75,161$ or $16 \%$ of total Company net sales for the nine months ended September 30, 2011 and 2010, respectively. The 59\% increase in net sales period over period was primarily due to our new Cejon business that we acquired in the second quarter of this year. In addition, net sales increases in our Big Buddha ${ }^{\circledR}$, Madden Zone, Steve Madden ${ }^{\circledR}$ handbags and belt businesses contributed to our net sales increase during the period ended September 30, 2011.

Gross profit margin in the Wholesale Accessories segment decreased to $35.3 \%$ in the first nine months of this year from $39.0 \%$ in the same period last year, primarily due to the addition of our Cejon cold weather accessories business which typically achieves lower gross margins than our existing handbag and belt businesses. In the first nine months of 2011, operating expenses increased to $\$ 23,593$ compared to $\$ 17,139$ in the first nine months of 2010 , primarily due to the incremental costs related to our recently acquired Cejon business. As a percentage of sales, operating expenses improved to $19.7 \%$ in the first nine months of 2011 from $22.8 \%$ in the same period of last year. Income from operations for the Wholesale Accessories segment increased $53.0 \%$ to $\$ 18,620$ for the nine months ended September 30,2011 compared to $\$ 12,169$ for the same period of 2010.

Retail Segment:
In the first nine months of 2011 net sales from the Retail segment accounted for $\$ 101,110$ or $15 \%$ of our total net sales compared to $\$ 89,053$ or $19 \%$ in the same period last year. We opened eight new stores, acquired one store as part of the acquisition of Topline and closed nine under-performing stores during the twelve months ended September 30, 2011. As a result, we had 82 retail stores as of September 30, 2011 and 2010. The 82 stores currently in operation include 72 Steve Madden full price stores, five Steve Madden outlet stores, three Steven stores, one Report store and one e-commerce website. Comparable store sales (sales of those stores, including the e-commerce website, that were open throughout the first nine months of 2011 and 2010) increased $12.0 \%$ in the first nine months of this year. The gross margin in the Retail segment increased to $60.5 \%$ in the nine months ended September 30, 2011 from $59.6 \%$ in the first nine months of 2010 primarily due to a decrease in promotional selling. During the nine months ended September 30, 2011, operating expenses decreased to $\$ 52,982$ from $\$ 53,973$ in the same period of last year. This decrease is partially due to a charge of $\$ 1,750$ in the third quarter of 2010 for the preliminary settlement of a class action lawsuit that was ultimately settled for less, resulting in a credit of $\$ 782$ in the second quarter of 2011 (see Note W to the Condensed Consolidated Financial Statements). In addition, operating expenses were impacted by a reduction in a number of operating costs as well as by several one-time credits totaling about $\$ 1,000$. Excluding the impact of the lawsuit settlement and the one-time charges, net income for the nine months ended September 30, 2011 was $\$ 6,365$ compared to $\$ 836$ during the same period of 2010. Inclusive of the impact of the lawsuit and the one-time charges, income from operations for the Retail segment was $\$ 8,170$ in the first nine months of this year compared to a loss from operations of $\$ 914$ for the same period in 2010.

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## First Cost Segment:

The First Cost segment generated income from operations of $\$ 8,605$ for the nine-month period ended September 30, 2011 , compared to $\$ 14,976$ for the comparable period of 2010 . The primary reason for this decrease is the transition of our Target private label and Olsenboye footwear businesses from the commission model to the wholesale model in 2011.

## Licensing Segment:

During the nine months ended September 30, 2011, licensing income increased to $\$ 6,043$ from $\$ 3,024$ in the same period of last year, primarily due to the incremental licensing revenue generated by our recently acquired Betsey Johnson® intellectual property assets.

## LIQUIDITY AND CAPITAL RESOURCES

(\$ in thousands)
The Company has a collection agency agreement with Rosenthal \& Rosenthal, Inc ("Rosenthal"). The agreement provides us with a credit facility in the amount of $\$ 30,000$, having a sub-limit of $\$ 15,000$ on the aggregate face amount of letters of credit, at an interest rate based, at our election, upon either the prime rate or LIBOR. The agreement can be terminated by the Company or Rosenthal at any time with 60 days' prior written notice. As of September 30, 2011, we have no borrowings against the credit facility.

On September 30, 2011, we had working capital of $\$ 197,553$. We had cash and cash equivalents of $\$ 35,141$, investments in marketable securities of $\$ 76,659$ and we did not have any long term debt.

Management believes that based upon our current financial position and available cash and marketable securities, we will meet all of our financial commitments and operating needs for at least the next twelve months.

## OPERATING ACTIVITIES

(\$ in thousands)
During the nine-month period ended September 30, 2011, net cash provided by operating activities was $\$ 7,385$. The primary source of cash was the net income for the nine months ended September 30, 2011. An additional source of cash was provided by the increase of accounts payable and other accrued expenses of $\$ 41,969$. The primary uses of cash were an increase in due from factor of $\$ 53,184$, an increase in accounts receivable of $\$ 40,030$ and an increase in inventory of $\$ 25,301$ primarily due to our new acquisitions, Topline and Cejon.

## INVESTING ACTIVITIES

(\$ in thousands)
During the nine-month period ended September 30, 2011, the Company received $\$ 64,885$ from the maturities and sales of securities and invested $\$ 13,983$ in marketable securities. We also paid $\$ 85,234$ for the acquisitions of Topline and Cejon. Additionally, during this period, the Company made capital expenditures of $\$ 12,246$, principally for systems enhancements, the six new stores that opened in the current period and leasehold improvements to our showrooms and offices.

## FINANCING ACTIVITIES

(\$ in thousands)

During the nine-month period ended September 30, 2011, we received $\$ 4,005$ in cash and realized a tax benefit of $\$ 4,178$ in connection with the exercise of stock options.

## CONTRACTUAL OBLIGATIONS

(\$ in thousands)
Our contractual obligations as of September 30, 2011 were as follows:

|  |  |  | ment due by |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Contractual Obligations | Total | Remainder of 2011 | 2012-2013 | 2014-2015 | 2016 and after |
| Operating lease obligations | \$148,505 | \$5,556 | \$41,785 | \$37,196 | \$63,968 |
| Purchase obligations | 126,548 | 126,548 | - | - | - |
| Contingent payment liability | 40,023 | 3,787 | 22,501 | 9,360 | 4,375 |
| Other long-term liabilities (future minimum royalty payments) | 2,048 | 355 | 1,693 | - | - |
| Total | \$317,124 | \$136,246 | \$65,979 | \$46,556 | \$68,343 |

At September 30, 2011, we had open letters of credit for the future purchase of inventory of approximately $\$ 4,129$.
We have an employment agreement with Steven Madden, our Creative and Design Chief and a principal stockholder of the Company, which provides for an annual base salary of $\$ 600$ subject to certain specified adjustments through December 31, 2019. The agreement also provides for annual bonuses based on EBITDA, revenue of any new business and royalty income over $\$ 2,000$, plus an equity grant and a non-accountable expense allowance.

We have employment agreements with certain executive officers, which provide for the payment of compensation aggregating approximately $\$ 685$ during the remaining three months of $2011, \$ 2,236$ in 2012 and $\$ 1,025$ in 2013. In addition, some of the employment agreements provide for discretionary bonuses or provide for incentive compensation based on various performance criteria as well as other benefits including stock options.

In connection with our acquisition of Cejon on May 25, 2011, we are subject to potential earn-out payments to the seller of Cejon based on the annual performance of Cejon for each of the twelve-month periods ending on June 30, 2012 through 2016, inclusive. In connection with our acquisition of Topline on May 20, 2011, we are subject to potential earn-out payments to the seller of Topline based on the performance of Topline for the twelve-month period ending on June 30, 2012. In connection with our acquisition of Big Buddha during the first fiscal quarter of 2010, we are subject to potential earn-out payments to the seller of Big Buddha based on the annual performance of Big Buddha for each of the twelve month periods ending on March 31, 2012 and 2013.

Approximately ninety-nine percent ( $99 \%$ ) of our products are produced overseas by unrelated foreign manufacturing companies, the majority of which are located in China, with the remaining located in Brazil, Italy, India, Spain and Mexico. We have not entered into any long-term manufacturing or supply contracts with any of these foreign companies. We believe that a sufficient number of alternative sources exist outside of the United States for the manufacture of our products. We currently make approximately $99 \%$ of our purchases in U.S. dollars.

## INFLATION

We do not believe that the price inflation experienced over the last few years in the United States has had a significant effect on the Company's sales or profitability. Historically, we have minimized the impact of product cost increases by improving operating efficiencies, changing suppliers and increasing prices. However, no assurance can be given that we will be able to offset any such inflationary cost increases in the future. We are currently seeing increases in our cost of goods from southern China averaging approximately $5 \%$ to $8 \%$. We are working to mitigate this pressure by shifting some production to northern China, where costs remain lower, and to a lesser extent, to other countries such as Mexico. We are also raising prices on select items with fresh materials or styling and, to date, have not seen resistance to these price increases. Putting this all together, the net impact of all these changes on gross margin was not material in the first nine months of 2011, and we expect that to be the case in the near term as well.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

## CRITICAL ACCOUNTING POLICIES AND THE USE OF ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our Condensed Consolidated Financial Statements which have been prepared in accordance with GAAP. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, and related disclosure of contingent assets and liabilities. Estimates by their nature are based on judgments and available information. Our estimates are made based upon historical factors, current circumstances and the experience and judgment of management. Assumptions and estimates are evaluated on an ongoing basis and we may employ outside experts to assist in evaluations. Therefore, actual results could materially differ from those estimates under different assumptions and conditions. Management believes the following critical accounting estimates are more significantly affected by judgments and estimates used in the preparation of our Condensed Consolidated Financial Statements: allowance for bad debts, returns, and customer chargebacks; inventory valuation; valuation of intangible assets; litigation reserves and cost of sales.

Allowances for bad debts, returns and customer chargebacks. We provide reserves against our trade accounts receivables for future customer chargebacks, co-op advertising allowances, discounts, returns and other miscellaneous deductions that relate to the current period. The reserve against our non-factored trade receivables also includes estimated losses that may result from customers' inability to pay. The amount of the reserve for bad debts, returns, discounts and compliance chargebacks are determined by analyzing aged receivables, current economic conditions, the prevailing retail environment and historical dilution levels for customers. We evaluate anticipated customer markdowns and advertising chargebacks by reviewing several performance indicators for our major customers. These performance indicators (which include inventory levels at the retail floors, sell through rates and gross margin levels) are analyzed by Management to estimate the amount of the anticipated customer allowance. Failure to correctly estimate the amount of the reserve could materially impact our results of operations and financial position.

Inventory valuation. Inventories are stated at lower-of-cost or market, on a first-in, first-out basis. We review inventory on a regular basis for excess and slow moving inventory. The review is based on an analysis of inventory on hand, prior sales, and expected net realizable value through future sales. The analysis includes a review of inventory quantities on hand at period-end in relation to year-to-date sales and projections for sales in the foreseeable future as well as subsequent sales. We consider quantities on hand in excess of estimated future sales to be at risk for market impairment. The net realizable value, or market value, is determined based on the estimate of sales prices of such inventory through off-price or discount store channels. The likelihood of any material inventory write-down is dependent primarily on the expectation of future consumer demand for our products. A misinterpretation or misunderstanding of future consumer demand for our products, the economy, or other failure to estimate correctly, in addition to abnormal weather patterns, could result in inventory valuation changes compared to the valuation determined to be appropriate as of the balance sheet date.

Valuation of intangible assets. Accounting Standards Codification ("ASC") Topic 350, "Intangible - Goodwill and Other", requires that goodwill and intangible assets with indefinite lives no longer be amortized, but rather be tested for impairment at least annually. This pronouncement also requires that intangible assets with finite lives be amortized over their respective lives to their estimated residual values, and reviewed for impairment in accordance with ASC Topic 360, "Property, Plant and Equipment" ("ASC Topic 360"). In accordance with ASC Topic 360, long-lived assets, such as property, equipment, leasehold improvements and goodwill subject to amortization, are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying
amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Litigation reserves. Estimated amounts for litigation claims that are probable and can be reasonably estimated are recorded as liabilities in our Condensed Consolidated Financial Statements. The likelihood of a material change in these estimated reserves would be dependent on new claims as they may arise and the favorable or unfavorable events of a particular litigation. As additional information becomes available, management will assess the potential liability related to the pending litigation and revise its estimates. Such revisions in management's estimates of a contingent liability could materially impact our results of operation and financial position.

Cost of sales. All costs incurred to bring finished products to our distribution center and, in the Retail segment, the costs incurred to bring products to our stores are included in the cost of sales line item on our Condensed Consolidated Statement of Income. These include the cost of finished products, purchase commissions, letter of credit fees, brokerage fees, material and labor and related items, sample expenses, custom duty, inbound freight, royalty payments on licensed products, labels and product packaging. All warehouse and distribution costs are included in the operating expenses line item of our Condensed Consolidated Statements of Income. We classify shipping costs to customers, if any, as operating expense. Our gross profit margins may not be comparable to other companies in the industry because some companies may include warehouse and distribution costs as a component of cost of sales, while other companies report on the same basis as we do and include them in operating expenses.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (\$ in thousands)

We do not engage in the trading of market risk sensitive instruments in the normal course of business. Our financing arrangements are subject to variable interest rates, primarily based on the prime rate and LIBOR. The summarized terms of our collection agency agreements with Rosenthal \& Rosenthal can be found in the Liquidity and Capital Resources section under Item 2 and in Note E to the notes to the Condensed Consolidated Financial Statements included in this Quarterly Report.

As of September 30, 2011, we held marketable securities valued at $\$ 76,659$, which consist primarily of corporate and U.S. government and federal agency bonds. These investments are subject to interest rate risk and will decrease in value if market interest rates increase. We have the ability to hold these investments until maturity. In addition, any decline in interest rates would be expected to reduce our interest income.

## ITEM 4. CONTROLS AND PROCEDURES

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the fiscal quarter covered by this Quarterly Report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) were, as of the end of the fiscal quarter covered by this Quarterly Report, effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

As required by Rule 13a-15(d) under the Exchange Act, our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated our internal controls over financial reporting to determine whether any changes occurred during the quarter covered by this Quarterly Report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, there has been no such change during the quarter covered by this Quarterly Report.

## PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS
(\$ in thousands)
On June 24, 2009, a class action lawsuit, Shahrzad Tahvilian, et al. v. Steve Madden Retail, Inc. and Steve Madden, Ltd., Case No. BC 414217, was filed in the Superior Court of California, Los Angeles County, against the Company and its wholly-owned subsidiary alleging violations of California labor laws. The parties submitted the dispute to private mediation and, on August 31, 2010, reached a settlement on all claims. Based on the proposed settlement, the Company increased its reserve for this claim from $\$ 1,000$ to $\$ 2,750$ in the third quarter of 2010. In June of 2011, the court approved the final settlement for $\$ 1,968$. The payment of the final settlement did not have a material effect on the Company's financial position.

On August 10, 2005, following the conclusion of an audit of the Company conducted by auditors for U.S. Customs and Border Protection ("U.S. Customs") during 2004 and 2005, U.S. Customs issued a report that asserts that certain commissions that the Company treated as "buying agents' commissions" (which are non-dutiable) should be treated as "selling agents' commissions" and hence are dutiable. Subsequently, U.S. Immigration and Customs Enforcement notified the Company's legal counsel that a formal investigation of the Company's importing practices had been commenced as a result of the audit. In September of 2007, U.S. Customs notified the Company that it had finalized its assessment of the underpaid duties at $\$ 1,400$. The Company, with the advice of legal counsel, evaluated the liability in the case, including additional duties, interest and penalties, and believed that it was not likely to exceed $\$ 3,045$, and accordingly, a reserve for this amount was recorded as of December 31, 2009. The Company contested the conclusions of the U.S. Customs audit and filed a request for review and issuance of rulings thereon by U.S. Customs Headquarters, Office of Regulations and Rulings, under internal advice procedures. On September 20, 2010, the Company was advised by legal counsel that U.S. Customs had issued a ruling in the matter, concluding that the commissions paid by the Company pursuant to buying agreements entered into by the Company and one of its two buying agents under review were bona fide buying-agent commissions and, therefore, were non-dutiable. With respect to the second buying agent, U.S. Customs also ruled that beginning in February of 2002, commissions paid by the Company were bona fide buying agent commissions and, therefore, were non-dutiable. However, U.S. Customs found that the Company's pre-2002 buying agreements with the second agent were legally insufficient to substantiate a buyer-buyer's agent relationship between the Company and the agent and that commissions paid to the second agent under such buying agreements, in fact, were dutiable. The Company is reviewing the ruling, its consequences and the Company's options with its legal counsel. On the basis of the U.S. Customs ruling, the Company reevaluated the liability in the case and believes that it is not likely to exceed $\$ 1,248$ and the reserve was reduced from $\$ 3,045$ to such amount as of September 30, 2010.
U.S. Customs has not made a formal claim for collection of the duties allegedly owed and, as the statute of limitations for commencement of a collection claim is expiring, U.S. Customs has requested a waiver from the Company of the statute of limitations until December 5, 2013. The Company has submitted a proposed waiver of the statute of limitations to U.S. Customs in this regard the terms of which have not yet been agreed upon. If the Company and U.S. Customs do not reach agreement regarding the terms of the waiver, the statute of limitations for the commencement of a collection action will expire on December 5, 2011.

We have been named as a defendant in certain other lawsuits in the normal course of business. In the opinion of management, after consulting with legal counsel, the liabilities, if any, resulting from these matters should not have a material effect on our financial condition or results of operations. It is the policy of management to disclose the amount or range of reasonably possible losses in excess of recorded amounts.

Certain other legal proceedings in which we are involved are discussed in Note N to our Condensed Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 and in Part I Item 3 of that Annual Report. Unless otherwise indicated in this Quarterly Report, all proceedings discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 which are not indicated therein as having been dismissed or otherwise concluded remain outstanding.

## ITEM 6. EXHIBITS

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
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101 The following materials from Steven Madden, Ltd.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets; (ii) the Condensed Consolidated Statements of Income; (iii) the Condensed Consolidated Statements of Cash Flows; and (iv) Notes to Condensed Consolidated Financial Statements, tagged as blocks of text.*

* This exhibit shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any filing, except to the extent the Company specifically incorporates it by reference.


## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form $10-\mathrm{Q}$ to be signed on its behalf by the undersigned thereunto duly authorized.

DATE: November 9, 2011
STEVEN MADDEN, LTD.
By: /s/ EDWARD R. ROSENFELD
Edward R. Rosenfeld
Chairman and Chief Executive Officer
By: /s/ ARVIND DHARIA
Arvind Dharia
Chief Financial Officer and Chief Accounting Officer

Exhibit Index
Exhibit No. Description
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