ALLIANCE RESEARCH

Tenant Credit Review

Helping the Commercial Real Estate Industry Reduce Financial Risk Since 1989

Skechers U.S.A., Inc. and Subsidiaries

Highlights

Key Positives

- Skechers' sales grew at double-digit rates in the full fiscal years 2017-2019 and sales are seeing a strong rebound in the first half of 2021 after the COVID-related decline in 2020.
- The Company is projecting FY 2021 sales at $6.15-6.25 billion, which would imply growth of over 33% y/y.
- Outside of 2020, the Company's annual gross profit and EBITDA margins have been consistent.
- Margins improved significantly in the first half of 2021, with EBITDA already at $452 million for just the first six months.
- The balance sheet is strong, with minimal debt and > $1billion in cash.
- The Company's free cash flow (FCF) was decidedly positive in the years we reviewed, surpassing $300 million in the first six months of 2021, easily covering principal and interest payments.
- As of June, Skechers' available liquidity was $1.7 billion, including $1.1 billion in cash, $107.6 million in short-term investments, and $475.5 million in revolver availability.

Key Negatives/Risks

- The COVID-pandemic has had an impact on sales, leading to a decline of (12%) in 2020, and subsequently EBITDA fell nearly 50% to $341.7 million in 2020.
- Skechers faces intense competition in the global footwear industry, in varying degrees, depending on the product category involved.
- The recent strong sales growth may not continue as government stimulus wanes and potentially consumer spending trends shift.
- The current margin boost, driven by a lack of promotional activity, may not be sustainable.
- Their brick and mortar stores face increasing competition from online retailers.
- Skechers has been involved in a number of lawsuits, though the ultimate financial impact is still too early to tell.

Financial Highlights

($ 000)	2018	2019	2020	6 mos. 2021
Revenues	$4,642,068	$5,220,051	$4,597,414	$3,087,191
EBITDA	577,913	671,034	341,734	452,213
Cash & equiv.	872,237	824,876	1,370,826	1,091,355
Total assets	3,228,255	4,892,943	5,812,369	5,764,731
Total debt	97,007	121,206	734,962	312,035
Equity	2,189,275	2,536,107	2,725,663	3,014,104

Conclusions

Risk Assessment/Credit Quality

Our rating of the level of tenant risk (see Rating Guide on page seven) in a lease with Skechers reflects the Company's healthy operating performance and its strong balance sheet.

It appears that the COVID related revenue and profit challenges faced in 2020 are not persisting, and the Company is seeing a strong rebound into 2021, but we would caution that the current revenue levels and profit margins may not be sustainable. That being said, it would take a sizeable amount of persistent financial adversity to reach a point where payment of rent became an issue for Skechers, especially given the existing $1.1 billion cash balance and continued strong free cash flow generation. We would expect the Company to be a reliable tenant.

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September 10, 2021
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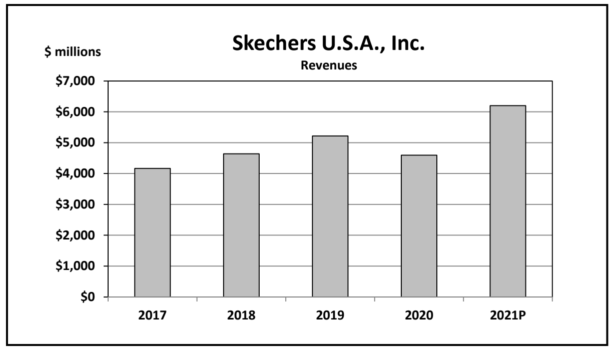
Analyst Notes

Revenues – Skechers' sales grew at double-digit rates in the full fiscal years 2017-2019; however sales fell (12%) in 2020, primarily due to the impact of the COVID-19 pandemic. Their direct-to-consumer business, which was about 26% of 2020 sales, was down about (20%) for the year due to temporary store closures and reduced operating hours due to the pandemic. The domestic wholesale business was about 25% of total revenue and international wholesale was 49% of total revenue, and both of these segments were also down (9.7%) and (8.3%), respectively, for the year. Total 2020 sales were $4.6 billion.



However, as the Company comps against the 1H 2020 temporary store closures and the initial impact of the pandemic, first half 2021 sales are showing a strong rebound, up 57% y/y to $3.1 billion. In the first six months of 2021, Skechers has benefited from higher selling prices and a significant increase in the number of units sold, as well as very strong international growth. As consumer trends are embracing the relaxed lifestyle, Skechers' comfort-based footwear and apparel products are gaining traction. The Company's international business is expected to continue to be a growth driver as it enhances its global reach via distribution networks, subsidiaries, and JVs.

Analysts are estimating total fiscal 2021 revenues of $6.27 billion, implying full y/y growth of approximately 36%. The Company is projecting slightly lower FY 2021 sales, at $6.15-6.25 billion, which would still imply growth of over 33% y/y at the lower end of the outlook.

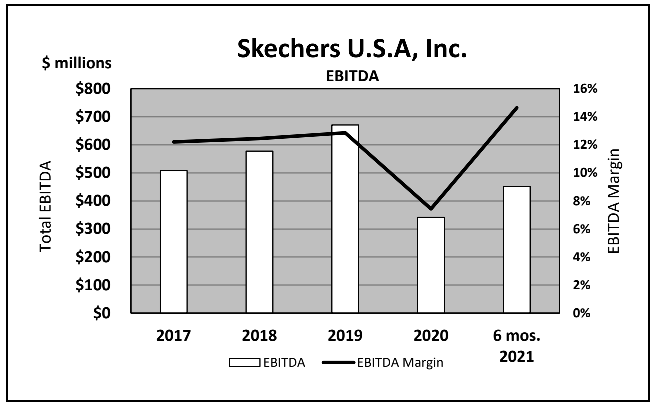
The Company sells its brands through department and specialty stores, athletic and independent retailers, boutiques and internet retailers, as well as through its own website (skechers.com). No customer is over 10% of sales and the top five customers together are 8.8% of sales, indicating minimal customer concentration. As of June 2021, the Company had 512 domestic and 339 international stores, for a total of 851 owned stores as well as 482 joint venture and 2,724 distributor, licensee, and franchise stores. The store count has steadily increased over the past several years. The Company's branded footwear are grouped into four categories, Lifestyle (comfort, style, and value footwear for men and women), Performance (the technical footwear lines designed for performance and comfort), Kids (footwear for kids of all ages), and Work (slip-resistant, safety-toe boots, hikers, and athletic shoes for professionals).

Skechers faces intense competition in the global footwear industry, in varying degrees, depending on the product category involved. In the casual and athletic shoe categories, the Company goes up against established brands like Nike, New Balance, Reebok and Adidas; and in the children's shoe category Wolverine World Wide is a top competitor. Skechers works to differentiate themselves with their value proposition. The apparel and footwear industry is highly competitive and is also subject to changing trends and preferences.

It should also be noted that consumer spending in a variety of areas has been boosted over the past year plus due to government stimulus checks and other government benefits, giving consumers more disposable income. This could have contributed to some of the recent sales growth, and we see risk that as that government stimulus wanes and/or as consumers turn back to prior spending areas like travel, entertainment, and restaurants, this could lead to a softening of sales. Furthermore, as e-commerce gains traction, a shift which has been accelerated by the pandemic, this could potentially impact Skechers' brick-and-mortar store base.

Analyst Notes

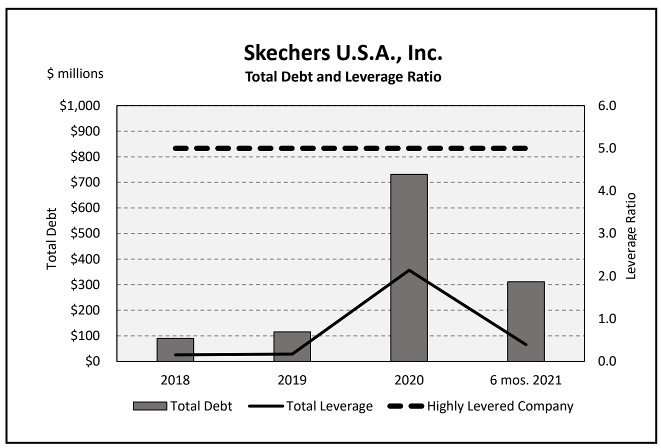
Profitability – As the adjacent chart shows, the Company's EBITDA margins were consistently within a narrow band of about 46.6-47.9% between 2017-2020. However, the Company has improved gross margins to record levels in the first half of 2021, coming in at 49.5% for the six months.



Similarly, EBITDA margins were right around 12-13% in 2017-2019, but then slipped to 7.4% in fiscal 2020 on the sales decline, with total 2020 EBITDA at $342 million, nearly cut in half from the 2019 level of $671 million. But, as we saw with gross margins, EBITDA margins have substantially improved in the first half of 2021, coming in at 14.6% for the six-month period, and EBITDA at $452 million, already surpassing the full-year 2020 level.

Higher average selling prices and reduced promotional activity led to an improvement in gross and ultimately EBITDA margins. It should be noted that reduced promotional activity is a current trend seen widely in the retail space, as with the various supply chain issues and ample funds provided by government stimulus, consumers seem to be more willing to pay higher prices. However, we do see risk that these higher margins are not sustainable as consumer behavior may ultimately return to being more promotional-focused.

Capitalization – Skechers' balance sheet is quite strong, with minimal debt that equates to a very low leverage ratio of 0.4x as of June 2021, based on LTM EBITDA of $794 million, and the cash levels more than covering the outstanding debt in all periods reviewed (we consider leverage ratios above 5.0 as "highly leveraged"). The Company recently repaid the outstanding borrowings on their revolver, which had been drawn in fiscal 2020, leaving nothing currently outstanding. The remining debt totals $269 million and consists of various construction and operating loans in both North America and China. The largest of these loans, at $129.5 million outstanding, has an effective interest rate of 4.08% after an interest rate swap in place and matures in 2025. There is also $47 million at a rate of 2.01% due 2025, $76 million at 4.15% due 2023, and $57 million at 4.28%. These loans are amortizing with $43 million of the total classified as current.

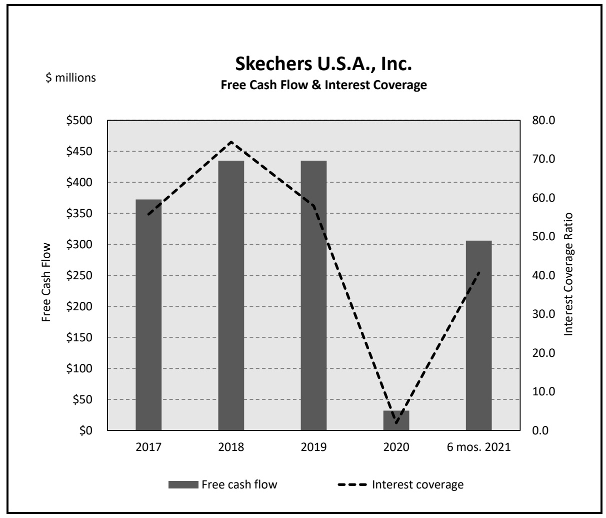


The Company's balance sheet is comfortably liquid with a current ratio of 2.8 at the end of 2020 and 2.4 as of the second quarter of 2021. The PP&E asset was also sizable, at $1,027 million and in addition to the $1,091 million cash balance, the Company also had $100.8 million in short-term investments, consisting of short-term corporate bonds, asset-backed securities, and U.S. agency securities.

Analyst Notes

Skechers is publicly traded, with a market capitalization of $7.3 billion. The stock has moved from the pandemic period lows of about $21/share in the height of the pandemic in March 2020 to $46/share as of September 2021.

Cash Flow/Liquidity – The Company's free cash flow (FC), calculated as EBITDA less capex, was positive in the years we reviewed, surpassing $430 million in 2018 and 2019, then dropping to $31 million in 2020 on the decline in EBITDA and increase in capex to $309 million. So far in fiscal 2021, FCF was $306 million through the first six month, despite capex remaining elevated at $146 million through the first six months. Capex for 2021 is expected to be $275-325 million, which appears manageable given the first half's strong FCF.



FCF easily covering interest payments overall for all periods reviewed, with interest coverage ranging frow a low of 1.9x at YE 2020 and over 40x for all other periods. FCF also easily covers the $43 million in current debt as of June 2021.

As of June 30, 2021, the Company's available liquidity included $1.1 billion in cash, $1.1 billion in short-term investments, and $475.5 million in revolver availability, for total available liquidity of $17 billion.

Skechers is also using cash to make regular distributions to non-controlling interests, with these payments around $30 million in 2018 and 2019, but accelerating to $81 million in 2020. Cash has also been historically used for repurchases of common stock and noncontrolling interests, and while recent payments on this front have been minimal, we do see this as a potential cash usage in the years ahead.

The Company is also involved in several lawsuits related to product infringement, California labor code, and other issues. These lawsuits are in various stages of legal proceedings, and it is still too early to determine if and what any ultimately financial impact would be.

Analyst Notes

Corporate Profile

Founded in 1992, Skechers is a global footwear and apparel brand. The Company designs, develops and markets more than 3,000 lifestyle and athletic footwear styles for men, women and children. Skechers sells its products in more than 170 countries across the globe through its established worldwide infrastructure and distribution capabilities.

The Company markets its products to both wholesale partners and through more than 4,050 Skechers-owned, JV, and third party-owned stores as well as online at skechers.com and through a presence on leading, global e-commerce platforms. Skechers has JVs in China, Hong Kong, Israel, Mexico, South Korea, Malaysia, Singapore, and Thailand.

In addition to its headquarters in Manhattan Beach, California, the Company has offices in North America, South America, Europe, and Asia and employs approximately 11,500 people. Skechers' products are produced by independent contract manufacturers located primarily in China and Vietnam.

Skechers trades on the New York Stock Exchange under the symbol SKX and carries a $7.6 billion market capitalization. The Company's Chairman/CEO and his immediate family owns 94% of the Class B stock, meaning he and his immediate family beneficially owned 43% of the aggregate number of voting shares as of YE 2020.

Scope of Analysis

Our analysis of Skechers included (i) a review of the Company's 10-K for fiscal 2018-2020 and its 10-Q for the second quarter of 2021; (ii) online search and review of information about Skechers; and (iii) a review of articles from trade and business publications.

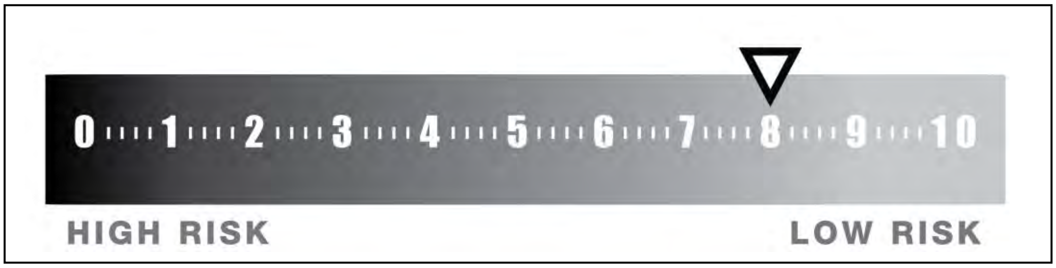
Skechers U.S.A., Inc. and Subsidiaries
Financial Spreadsheet

($ in thousands) *Fiscal year end Dec. 31*	*2017*	*2018*	*2019*	*2020*	*6 mos. 2021*
For the period					
Revenues	$4,164,160	$4,642,068	$5,220,051	$4,597,414	$3,087,191
Year-to-year growth rate	17%	11%	12%	(12%)	57%
# of stores	645	692	800	854	851
Pre-tax income (as reported)	384,260	431,884	516,005	154,729	346,862
EBITDA (adjusted)	508,292	577,913	671,034	341,734	452,213
Margins					
Gross margin	46.6%	47.9%	47.7%	47.6%	49.5%
EBITDA margin	12.2%	12.4%	12.9%	7.4%	14.6%
Expense ratios (% of revs.)					
G&A expense	29.9%	31.4%	31.1%	38.2%	31.2%
Sales & marketing expense	7.9%	7.5%	7.1%	6.9%	7.1%
Cash Flow					
EBITDA	508,292	577,913	671,034	341,734	452,213
Capital expenditures	(135,976)	(143,036)	(236,111)	(309,916)	(146,219)
Free cash flow	372,316	434,877	434,923	31,818	305,994
Interest expense	(6,677)	(5,847)	(7,509)	(16,327)	(7,530)
Interest coverage	55.8	74.4	57.9	1.9	40.6
From operating activities	159,337	568,552	426,552	331,453	317,161
From investing activities	(138,250)	(319,414)	(344,073)	(312,468)	(167,208)
From financing activities	(14,541)	(119,715)	(131,973)	533,302	(429,635)
Net change in cash & equiv.	6,546	129,423	135,806	545,950	(279,471)
At period end[1]					
Assets					
Cash & equivalents	736,431	872,237	824,876	1,370,826	1,091,355
Short-term investments	0	0	112,037	100,767	107,626
Accounts receivable (trade)	405,921	501,913	645,303	619,800	778,216
Inventories	873,016	863,260	1,069,863	1,016,774	1,057,284
Total current assets	2,105,024	2,472,140	2,819,591	3,344,351	3,246,035
Prop., plant & equip. (net)	541,601	585,457	738,925	935,441	1,026,777
Operating lease right of use			1,073,660	1,171,521	1,134,145
Total assets	2,735,082	3,228,255	4,892,943	5,812,369	5,764,731
Liabilities/Equity					
Accounts payable	505,334	629,553	764,844	744,077	831,910
Current portion of LT debt	1,801	1,666	66,234	52,250	42,547
Short-term borrowings	8,011	7,222	5,789	3,297	575
Total current liabilities	597,348	850,222	1,238,231	1,212,706	1,338,299
Long-term debt	71,103	88,119	49,183	679,415	268,913
LT operating lease liabilities			966,011	1,065,069	1,015,754
Stockholders' equity	1,948,211	2,189,275	2,536,107	2,725,663	3,014,104
Key financial ratios					
Current ratio	3.5	2.9	2.3	2.8	2.4
Quick ratio	2.1	1.9	1.4	1.9	1.6
Leverage ratio[2]	0.2	0.2	0.2	2.2	0.4
Net debt/EBITDA	<0	<0	<0	<0	<0

[1] These are balance sheet highlights. Certain line items have been excluded.

[2] 6-month 2021 leverage based on LTM EBITDA of $713 million.

Rating Guide



Tenant Risk[3]/Credit Quality

Rating	Tenant Risk	Credit Quality	Security Recommended
0 – 1	Very high	Deficient	Avoid as tenant
1 – 3	High	Unsafe	Full security
3 – 5	Worrisome	Poor	Full/Partial security
5 – 7	Some concerns	Fair	Partial security
7 – 9	Low	Good	None or partial security
9 – 10	Very low	Excellent	No security

This rating is based on an analysis of a company's key financial documents and business fundamentals, as well as comparative data drawn from the Alliance Group's proprietary Tenant Index of more than 6,000 companies that reside in our research database. In our peer group studies, IndexSearch software is used to categorize and weigh companies by size, industry, risk levels, and other key factors to narrow the peer group and insure a meaningful group of comparable companies.

Michael F. Calhoun has 25 years of experience in financial analysis, business management and corporate evaluation. He is President of The Alliance Group, a consulting firm specializing in corporate due-diligence studies, acquisition searches, business valuations and investment analysis services. Mr. Calhoun is a former investment analyst for both the Dreyfus Corporation and Oppenheimer Management.

[3] Tenant Risk refers to the possibility that a tenant will default during the life of a lease.