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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Fossil Group third-quarter FY16 earnings conference call.

(Operator Instructions)

I would now like to turn the call over to Eric Cerny, Investor Relations. Sir, you may begin.

Eric Cerny ***Fossil Group, Inc. - IR***

Thank you. Good afternoon, everyone. Thank you for joining us. Welcome to Fossil Group's third-quarter 2016 earnings conference call. I'd like to remind you that information made available during the conference call contains forward-looking information, and actual results could differ materially from those that will be projected during this call. Fossil Group's policy on forward-looking statements and additional information concerning a number of factors that could cause actual results to differ materially from such statements is readily available in our Form 10-K and 10-Q reports filed with the SEC.

In addition, the Company assumes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. Please note that you can find the reconciliation and other information regarding non-GAAP financial measures discussed on this call in our earnings release filed on Form 8-K and in the investor section of our website. Please note, you may listen to a live webcast or replay of this call by visiting FossilGroup.com under the investors section. Now, I would like to turn the call over to the Company's Chairman and CEO, Kosta Kartsotis.

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Thanks, and good afternoon, everyone. I will begin with a few prepared remarks before turning the call over to Dennis Secor, our Chief Financial Officer. Following his prepared remarks, Greg McKelvey our Chief Strategy, Marketing, and Digital Officer will join us for the Q&A. With our third quarter behind us and our results in line with our expectations, we have entered the fourth quarter well-positioned with our new wearables in the marketplace and by all measures, they are off to a great start. From that perspective, we are very pleased with our team's effort and the ability to launch our new wearables across eight brands over the last couple of months.

We achieved this through the great work of our entire organization with everyone focused on delivery and over 100 SKUs including display smart watches, hybrids, and activity trackers in 40 countries and 20 different languages. While these launches were a monumental accomplishment and a huge milestone for the Company, we know that this is truly just the beginning of our wearables journey and of the opportunity it represents for the Fossil Group. In less than one year, we have fully integrated misfits team into the

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organization, leveraged their platform, and deployed new technology and functionality over much of our portfolio. We know we have lots of work ahead of us and there will be new challenges along the way as we expand on our early success, but we continue to believe that this is a very exciting and unique opportunity for us to ignite the watch category and to change the trajectory of our business.

While headwinds in traditional watches remain, we performed well against our strategic objectives, which is important given their ability to drive long-term sustainable growth and improve profitability. The advances we are making in these areas of our business give us confidence that we are on the right path and are developing the right strategies. Let me take a few minutes to share our performance against those objectives. The resiliency of the Fossil brand continues to be extremely encouraging, particularly as we are investing in brand building activities for the future. Of course, part of our growth will come from wearables. We are very excited about the media campaign behind our second-generation Fossil Q products that include print, social media, and TV, and these will run again during the holiday season. We are gaining lots of attention from fans of the brand as well as new customers around the world.

Skagen also delivered another quarter of solid growth with particularly strong performance in watches. We've also just launched Skagen's first connected trackers and hybrid watches. These are amazing new products that combine technology with Skagen's sleek and distinctive styling. We're pleased that we're driving our growth both for Fossil and Skagen with strong performances in watches with wearables being the key driver of that growth in Fossil. The performance of these brands, particularly in a retail environment that continues to face persistent challenges, validates our investments and continued efforts to grow these brands. Investments in digital marketing, CRM and omnichannel, continue to deliver results. Even with the continuing traffic headwinds facing all retailers, we are improving conversion with great products and store experiences as we use CRM and digital marketing to drive the right customers into our stores.

We are engaging our customers in new and creative ways like our Fossil Q designer watch face contest. This is a great opportunity to further interact with customers and build excitement for our new wearable product. We continue to advance our omnichannel capabilities to win customers in the digital age of retailing. We accelerated eCom growth in the quarter as we provided customers the opportunity to preorder our wearable product to ensure access to the newest products. While still a small portion of our direct to consumer channel, our online business was up nearly 50% in the quarter.

Finally wearables, we successfully launched our second-generation wearables across not only our own brands but multiple licensed brands. These are the first products launched for our licensed brand partners and all indications are that the customer is excited about this convergence of technology and fashion lifestyle brands. While volumes are still modest and will accelerate as we move forward, the market attention has been encouraging. Michael Kors Access has been very strong out of the gate supported by a powerful and high-impact marketing campaign from the brand. Demand so far has exceeded our expectations and we are already stretching our supply chain to support greater demand. To show the scope of our wearables launch, we have added a wearables presentation to our investor relations website where you can see product images and the functionality of the new products across many of our brands.

Wearables is new, and we're learning as we progress. We can see that playing out with the Michael Kors launch. We expect we will learn even more from the important holiday season. We are especially excited about our hybrid watch launches across a total of seven brands. We believe these are truly unique products that will bring more interest and new customers to the watch business. At first glance, these watches look just like traditional watches incorporating all the same design, styling, and fashion that have given us a strong competitive advantage. The enhanced feature set is broad incorporating fitness tracking, notifications, and a robust branded app experience, all powered by traditional coin cell batteries. These can be game-changing products and give us significant opportunity for share gains and we will be working hard to educate consumers about the capabilities and features of these watches.

As an organization, we are focused on the wearable technology opportunity across all the product categories. We believe our new products represent the future for fashion accessories, and we believe our capabilities and strategic advantages provide us with the best chance to exploit the category. There has been a significant amount of change in our industry and our Company, and we expect that to continue. Our opportunity lies in us taking a leadership position in the watch business and transforming it with innovations and technology. The growing interest in connected accessories and our early success in the space reinforce our need to deploy our resources behind this category and our most compelling growth opportunities.

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To that end, today we announce that our team has begun working on a multi-year plan to reinvent the Fossil Group. While it is early in the process, we envision a comprehensive plan that will evolve our model and the way we work, the way we develop product, and the way we bring our products to market. We expect the program will touch all aspects of our business as we enhance our operational capabilities, gain greater efficiencies, and take optimal advantage of our considerable scale. We will review and adjust our overall structure with an eye toward streamlining the way we work to respond to the changing needs and demands of our customers and we'll examine and adjust our store fleet to reflect the evolving shopping habits of today's consumer. Our goal of the project, which we have named New World Fossil, is to over time improve our financial performance and build an improved operating platform that is quick and responsive and will be in a position to drive long-term shareholder value.

We will keep you informed as it evolves, and Dennis will share at least some of our initial thinking on the financial implications of this program. In closing as you've heard today, our team remains laser focused on our strategic priorities. First, driving future growth through wearable technology. Second, a continued commitment to further grow Fossil and Skagen. Third, evolving and leveraging our digital and omnichannel investments to better serve the customer. Finally, improving our profitability and growing our core watch business. This is a key priority for us and the New World Fossil will be the vehicle to deliver this. It built on our team's great work so far to reduce infrastructure and store expenses and to redeploy those resources behind new growth opportunities.

We will continue to update you on all of our initiatives and look forward to sharing more details regarding latest wearable products on our next earnings call. We are confident in our strategies and believe that our global operating platform, powerful portfolio brands, and our ability to lead in wearables uniquely position us to expand our addressable market and to drive growth. By combining our scale, competitive advantages, and improved operating capabilities, we believe we can improve our financial performance, build a nimble and responsive operating platform, and drive long-term shareholder value. Now, I would like to turn the call over to Dennis for more detail.

Dennis Secor ***Fossil Group, Inc. - CFO***

Thanks, Kosta, and good afternoon, everyone. For the third quarter, overall sales were in line with our expectations as headwinds in traditional watches continue to pressure our results. However, as Kosta mentioned, the launch of our second-generation wearables offset some of those headwinds. While the timing of the launch late in the quarter limited the impact on total Company results, early indications are very encouraging for the fourth quarter, and more importantly, for the long-term opportunity to return growth to our core category. Overall, third-quarter reported net sales decreased 4% to $738 million with minimal impact from currency. Constant dollar sales declined in the Americas and Europe while Asia grew.

Fossil and Skagen continued their momentum with both brands increasing during the quarter driven by growth in watches. Both brands also grew in Europe and Asia. In constant currency, fossil increased 1% with a much stronger watch performance, while Skagen grew 8%. For the quarter, diluted earnings per share were $0.36 and included two significant unusual items. First, we recorded a $0.16 gain from real estate transactions, $0.10 of which relate to the sale and leaseback of our US distribution center. We also recorded a $0.22 restructuring charge primarily related to anticipated store closures that are part of our New World Fossil initiative.

Compared to the prior-year period, third-quarter EPS was also negatively impacted by $0.15 due to the strong US dollar and the benefit of last year's hedging activity, and a further $0.09 due to this year's Misfit purchase accounting charges. Last year's third-quarter EPS was $1.19, which included a $0.05 restructuring charge. From a sales perspective, Fossil grew 1% in constant dollars compared to last year. Watches, with particular strength in wearables, drove the increase in the brand while leathers and jewelry declined. Sales growth in Europe and Asia was partially offset by a decline in the Americas. Skagen sales grew 8% in constant dollars with watches driving the growth and leathers and jewelry also increasing. Growth in Europe and Asia was partially offset by a decline in the Americas.

In the retail channel, comps declined 3% with growth in Asia and flat comps in Europe offset by a comp decline in the Americas. Globally, our Fossil brand outlet outperformed our full price stores, which also put some additional pressure on our margins. Our relatively stronger outlet performance was driven by deeper promotions and easier year-over-year comp comparisons. Fossil Q continued to perform well in our full price stores though that performance was more than offset by weaker traditional watch sales and disappointing leathers performance. Traffic continues to be challenging in our retail channel as double-digit traffic declines continue to pressure performance. Our total watch business declined 2% in constant dollars compared to last year, a sequential improvement from the 9% decline in the second quarter, a change in trajectory driven by our latest wearables launches with even more launches to follow in the

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fourth quarter.

Jewelry and leathers declined during the quarter with the performance in leathers largely due to a weaker customer response to the new fall assortment. We are disappointed with our leathers performance, particularly considering our recent strength, and we're working hard to reverse this trend. Consistent with prior quarters, our wholesale channel continued to be the weaker channel with declines in the Americas and Europe offsetting growth in Asia. We believe that the introduction of the latest wearable product at the end of the quarter can prove to be a catalyst for the channel as the watch category evolves with the introduction of technology and new functionality.

In the Americas, third-quarter reported sales decreased 8% to $361 million, a 7% constant dollar decrease. Traditional watches and leathers drove the overall decline. In watches and across brands, kate spade new york and Tory Burch continued to deliver solid increases offset by declines in nearly all the other brands in the portfolio. though our Access watch did drive an improved trend for Michael Kors. While overall launches declined in the quarter, the sequential trend improved significantly with our expanding wearables offering. Within the region, trends in our wholesale sell-in improved given the launch of wearables. In traditional watches, we did observe a modest overall step-down in channel sell out trends though US department store trends remain stable.

In Europe, reported sales decreased 7% to $243 million, a 4% constant dollar decrease with declines in all product categories; however, watches improved sequentially supported by the new wearables product. Within the region, continued growth in Fossil and Skagen was offset by a decline in nearly all of the brands in the licensed portfolio with the exception of kate spade new york and Tory Burch. Modest growth in the Middle East and Eastern European markets was offset by declines in Germany, France, and the UK. We did experience a modest decline in sellthroughs from traditional watches in some key markets in the wholesale channel. In Asia, reported sales increased 12% to $134 million with constant dollar sales increasing 8%. We delivered growth in all three categories with particular strength in watches.

Constant dollar growth in South Korea, India, and China was partially offset by a decline in Japan. Comp store sales increased in the region in both our full price and outlet stores. In the quarter, gross profit decreased to $385 million and gross margin declined 200 basis points to 52.2%. Promotions to drive business in our outlets continued to be the most significant margin headwind. Wearables where margins are currently lower than traditional watches, also negatively affected margins along with the relative mix of off price sales in currency. Third-quarter operating expenses increased to $354 million including $15 million of restructuring costs and a benefit of $10 million associated with real estate transactions. Excluding those items, as expected, operating expenses in the quarter were slightly higher than last year with an increase in wearables infrastructure and Misfit purchase accounting partially offset by lower overall core infrastructure expenses.

Marketing expenses were slightly lower than last year as we moved some planned investments into the fourth quarter. Our third-quarter reported operating expense rate was 48% compared to 44.3% last year. Operating income decreased to $31 million including unfavorable impacts of $4 million from currency and $15 million from restructuring charges, partially offset by the $10 million benefit of real estate transactions. Operating margin decreased to 4.2% including a 50 basis point headwind from currencies, a 160 basis point headwind from restructuring costs, and 140 basis point benefit from property sales.

Third-quarter other income decreased $5 million to $2 million due to lower gains on foreign currency contracts compared to the prior year. Our effective income tax rate for the quarter was 25%, given the regional mix of earnings and the impact of restructuring charges, which are concentrated in the United States compared to last year's 22%, which benefited from the favorable impact of foreign tax credits. Third-quarter net income decreased to $17 million due to lower sales and gross margins, investments in wearables, restructuring charges, and a reduction in other income due to the prior-year benefit from hedging activity.

Now turning to our cash flows and balance sheet. For the quarter, operations consumed $13 million of cash compared to $28 million in the prior year. We invested $14 million in CapEx and reduced borrowing by $10 million. Net proceeds from real estate transactions totaled $42 million. We ended the quarter with roughly $236 million in cash compared to $302 million last year, and debt of $723 million compared to $807 million a year ago. Third-quarter ending inventory was $700 million, down 6% from last year with a significant double-digit reduction in traditional watch inventory offset by inventory growth in connected accessories as we prepare for the holiday selling season. Accounts receivable decreased by 3% to $321 million and wholesale DSOs increased one day compared to the prior year.

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Depreciation and amortization expense totaled $24 million for the third quarter.

Moving now to our outlook. Since our last call, we have undertaken two initiatives that will have significant impact on our 2016 financial results. The sale and leaseback of our US distribution center and restructuring activities mainly related to future store closures. To help facilitate an understanding of our operational performance against our prior expectations, I will isolate the impact of these two new items and provide analysis that excludes them. At the end, however, I will provide our GAAP guidance, which will include these items. We've also provided a table in today's earnings release that quantifies each of these items and their impact on our 2016 GAAP results.

On our last call, we shared what we saw as the principal risk that we reflected in our earnings guidance range. First, the traditional watch market has been challenging and difficult to predict, and just as we saw in the first quarter, we could see a further step-down in trend. Second, we're pursuing an ambitious wearables agenda this year. This is a new business for us and many of our channel partners with a lot to get done to bring products through our supply chain, execute marketing plans, drive initial sell-in, and then reorder. And finally, competitive pressures or sales shortfalls could affect our margins as we manage our inventories and working capital carefully. In some measure, we do anticipate some level of each of these three risks affecting our results this year, though all roughly within the ranges that we had been expecting going into the quarter.

In our core business, traditional watch trends, mainly in wholesale channels, did weaken slightly in both the Americas and Europe though not as significantly as they did in the first quarter. And our leathers business, which had been strong for the last several quarters, did not perform as we had expected. Our updated guidance for -- (technical difficulty). And in wearables, we're very pleased with all we accomplished in the third quarter, as Kosta mentioned earlier. Demand for Michael Kors Access has exceeded our expectations, and our second-generation Fossil Q launch is going well. Our most significant marketing investment, a substantial double-digit increase over last year, will come in the fourth quarter to more broadly support our holiday business across all channels as well as the launch of our new hybrid watches.

One month into the fourth quarter, we've launched more brands and SKUs and now have wearables products in the market across all of the eight brands that we had planned this year. We're pleased that we hit nearly all of our delivery dates given how quickly we've ramped our wearables supply chain, though we did experience some modest delays which will affect this year's shipments. We've also now updated our shipping plans with our partners and expect that some anticipated Q4 sell-in will now shift into the first quarter. Our ambitious wearables plan remains in place, and we continue to expect that wearables can be the catalyst to drive fourth quarter growth. Therefore, for the full year, we now expect revenues will decline in a range between 3% and 5%, which includes roughly a 1 point headwind due to the impact of currencies.

For the fourth quarter, we expect revenues will be in the range of a 2% decline and a [4% increase] (corrected by company after the call) impacted negatively by roughly 80 basis points from currency headwind. We continue to expect that full-year gross margins will be lower compared to last year as the impact of currencies, outlet promotions to drive sales, and off-price selling will more than offset the favorable benefits from international mix, this year's greater mix through direct channels, and our margin improvement initiative. We are also planning fourth-quarter gross margins to be down versus last year driven generally by similar dynamics as well as the greater impact of wearables mix, which currently deliver lower margins than traditional watches.

On expenses, let me first discuss our more normalized operating expenses, which exclude restructuring costs, impairments, real estate gains, last year's Misfit acquisition costs, as well as Misfit purchase accounting charges. For the fourth quarter, we expect that our normalized operating expenses will be roughly flat. Given our significant efforts this year to optimize our infrastructure, we're expecting core infrastructure costs will be down significantly in the quarter. Direct retail expenses will also decline compared to last year. Those expense declines will offset a substantial increase in advertising and marketing and the build-out of our connected devices infrastructure. For the full year, the expense dynamics are similar where overall normalized operating expenses will be roughly flat.

In addition to the normalized operating expenses, last year in the fourth quarter, we also recorded $20 million in total related to impairments, Misfit acquisition costs, and last year's restructuring activities. This year, Misfit-related purchase accounting charges total roughly $6.5 million a quarter or $26 million for the full year. Therefore based on these factors, we now expect full-year adjusted operating margin, which again excludes this year's gain from the sale and leaseback of our US distribution center and restructuring

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charges, in the range between 5% and 6%, and adjusted full-year EPS in the range between $1.80 and $2.30. This assumes a tax rate of roughly 28% and currencies at roughly prevailing rates. We feel that this range is the most comparable to last quarter's full-year guidance.

For the fourth quarter, we expect adjusted operating margin in the range between 8.5% and 11%, and adjusted EPS in the range between $1.07 and $1.57. Now, with respect to this year's new real estate and restructuring activities. Our third-quarter results include the favorable $0.10 per share impact from the sale and leaseback of our US distribution center and the unfavorable $0.22 per share impact primarily related to impairments for stores that we now expect to close. In addition, we expect to record additional restructuring charges primarily related to exiting store leases that could be as high as another $0.38 per share based on our current estimates. The timing of these charges will depend on lease negotiations, which are difficult to predict.

Based on the assumption that we complete all of these negotiations by the end of 2016 and within the financial parameters we expect, our full-year GAAP EPS would range between $1.30 and $1.80 per share, and fourth-quarter GAAP EPS would range between $0.69 and $1.19. And GAAP operating margin for the year in the range of 4% to 5%, and for the fourth quarter in the range of 5.8% to 8.5%. And finally, we now expect CapEx for the full year to be in the range between $65 million and $70 million.

Before we open up for your questions, I would like to follow-up on Kosta's comments and share some of our initial thoughts on the financial implications of our New World Fossil initiative. Broadly speaking, we view the program as a multi-year initiative to drive profit improvements over time as we streamline our operations, gain greater operating efficiencies, take greater economic advantage of our scale, optimize our structure, and adjust our overall brick-and-mortar retail footprint. Our preliminary view, though still early and which could change, is to ultimately drive annualized operating profit improvements over current levels in excess of $200 million. This would align with our longer-term goal to restore our most recent operating margin performance outside of the impact of currencies though the timing of delivering on that goal depends on achieving stability and then growth in our core business and driving growth with wearables.

Based on our current expectations of the scope of the program, we would expect to record restructuring charges of as much as $150 million over that time between cash and non-cash with the majority of those charges to be recorded in 2017 and even into 2018. This total amount also includes the restructuring charge we just recorded in the third quarter as well as the amount included in our Q4 guidance, most of which relates to store closures.

And with that, we'll open up the call to your questions. To give everyone a chance to participate, please limit yourself to one single-part question. If you have further questions, please re-queue and we'll get to as many questions as time permits.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Simeon Siegel, Nomura.

Simeon Siegel ***Nomura Securities Intl - Analyst***

Dennis or Kosta, can you talk about the moving pieces in gross margin? Maybe particularly, can you quantify the delta between wearables and traditional watches? And then maybe just speak to the go-forward margins. Any thoughts on the ongoing outlet pressure and the increase in mix of off-price sales? Thanks.

Dennis Secor ***Fossil Group, Inc. - CFO***

Sure. The overall margins have been declining over this past year, more severely in the first part of the year. We are expecting those headwinds to narrow somewhat. Currency should become less of a headwind in the fourth quarter, certainly compared to where it was at the beginning of the year. We did go deeper on promotions and really turned those on last fourth quarter, so the fourth quarter comparisons should get easier assuming we are not compelled to drive even more.

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And in terms of the wearables, they continue to be right now, dilutive to our overall margin structure so as they become a larger part of a mix, that creates some headwinds. Now if we turn and look to the future, we see opportunities to improve on that, and technology and scale should help us there. There are opportunities for us as we are adding more value to the product to drive additional AUR. So we think those can improve over time but in the near term, they are going to be headwinds in the model.

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Also on wearables, we do get the additional benefit of having a much higher average unit retail. So as Dennis mentioned, we're going to be pushing to get to scale as quick as possible so we can get this thing moving on so we can reduce our costs. We already know that we can sell this merchandise at scale like we've shown in the third quarter. So our objective is to adjust the model as we go.

Simeon Siegel ***Nomura Securities Intl - Analyst***

Any color on what that margin delta would be at scale given the higher retail?

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Sorry. What was the question?

Simeon Siegel ***Nomura Securities Intl - Analyst***

Once you get the business to scale, any color on what the delta would be just given the -- to your point about the higher retail? What that margin would be between wearables and traditional watches.

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

It's still too early to tell. We just have one quarter under our belt and we're testing all different types of things. New distribution channels, new ideas, new pricing, we've got new visual treatments, there's training out there. We are really in a test and learn iterative process. A lot of that is just figuring out what the ultimate margin is going to be, but we --just having the kind of sellthroughs we're getting leads us to believe that there's a lot of levers we can pull to adjust our model to get to the point we need to be.

Simeon Siegel ***Nomura Securities Intl - Analyst***

Great, thanks, guys. Best of luck for holiday.

Operator

Omar Saad, Evercore ISI.

Omar Saad ***Evercore ISI - Analyst***

I wanted to ask could you guys maybe expand a little bit on the profit improvement initiatives. Are we really talking about kind of a cost restructuring and cost savings initiative? I think you mentioned closing underperforming stores that was one of the tangible things you pointed to, but maybe give us an idea of some of the other types of activities that will be involved over the next year or two as you dive into this?

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

It's really a process to reinvent the entire Company basically. And if you take a look at how the consumer market has changed and continues to change, it is not going back. We want to make sure we adjust our model to the reality today, and we have a lot of opportunity to do that. We have been -- if you look at the market today, you could say there are old world merchandising companies and new world and we're very quickly moving into the new world. We spent a lot of time over the last couple of years talking to our teams about thinking differently, reinventing, being a new world company, especially as it comes to technology both on bringing out technology products and wearables, et cetera, but also getting better at all things digital retailing, social media, omnichannel, eCommerce, et cetera.

And as you know, we've made a number of investments in both of those. So the idea around New World Fossil is basically we've been working with a strategy consulting company to look at every single part of the Company looking at how we can get faster, leaner, more efficient, put more resources behind our ideas that drive sales and profitability. And looking at benchmarking other companies, looking at best practices. We've already identified a number of significant things that we can work on, keeping in mind also that the Company

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grew from $1 billion to $3 billion very quickly. It's a very complex matrix, global organization.

I'd say building it that quickly, we don't necessarily have the most elegant process in place globally, especially tuned to the new world and the way it's changing. So a lot of it is just adjusting all that. We will have significant opportunity in reducing our SKU count, getting faster to market. Really speed is very, very critical to us, especially now. I think us being able to have fewer SKUs telling fewer stories to the consumers and have them be well told, especially in a digital world, I think will -- there's huge advantages in that. But we've already identified significant ways to get more efficient, faster, better, reinvent the Company, tune it to the new world, more digitized.

We think there's additional benefits in there. It's not just cost cutting, although that's -- there's some of that involved. It's really more figuring out how we can build product better with more efficiency, higher margins, go to market faster, carry less inventory, sell more with less. We've already identified a number of opportunities, and we're going to be really working on it over the next couple years.

Operator

Oliver Chen, Cowen and Company.

Oliver Chen ***Cowen and Company - Analyst***

Kosta, you have also talked a lot about test, read, and react in the past. So in the New World Fossil model, what would you say is different in terms of your ability to do that even better in terms of the quick response strategy? And I'm a little concerned in terms of SKU breadth and the complication of inventory management as you engage in the wearables strategy, which seems imperative. But how do we get comfort around managing the right level of breadth and depth across what's an emerging technology? And it looks like you're implementing a kind of a matrix across Q versus hybrids versus trackers. So how do we get comfort about the ability to test, read, and react in the context of that complexity as well?

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

First of all, I'd just say remember that our overall mission is to gain share in the traditional watch business. It just so happens the way to do that is with innovation and differentiation with technology. So in the process of reducing SKU count in all our brands and all our distribution globally, we think we have a lot of opportunity to do that. We actually -- if you look at our wearables launches, we're going to launch over 100 units, but our sales per unit are much higher than the rest of our Company.

So wearables because of the technology involved and the complexity of the apps and the execution is really kind of forcing us to have fewer SKUs that mean more, and that -- we're trying to help the rest of the Company learn from that. And I think we're really in a world where especially when you think digitally, a lot of eCommerce is happening on the phone. Consumers don't want to see a full assortment of products like they would in the old world in a huge department store shop. They really want to see fewer ideas told well.

And I think the whole wearables conversation and the amount of discussion in blogs and magazines and just in the general internet about individual products with reviews and everything else really is going to help lead us to a business model where we have fewer SKUs, more efficiency, better return, and more cost effective production, designing for value, having more efficiency, larger orders per style, per order, et cetera. There's just a lot of benefits I think that we're going to get out of it.

Greg McKelvey ***Fossil Group, Inc. - Chief Strategy and Digital Officer***

One other thing I'd add is the retail science and the ability to analyze sellthrough and then have that plug all the way back into the supply chain so we can quickly fulfil and respond to what's selling. We have got the same process in place for wearables, and we've just extended that all the way through the supply chain. It is leveraging that exact process that happens today.

Operator

Ike Boruchow, Wells Fargo.

Ike Boruchow ***Wells Fargo Securities - Analyst***

Dennis, quick question. It's on the wearables. It sounded like you said the traditional watch business didn't get any better in the quarter, but your total watch sales got about 8 points of sales better. So just doing some quick math. Does that mean your wearable dollars

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sell-in for the quarter was around $40 million to $50 million? And if not, could you help me understand what maybe that looked like? And then, what's your kind of embedded in your guidance for holiday in terms of how big -- in terms of dollars or penetration?

Dennis Secor ***Fossil Group, Inc. - CFO***

We have not specifically quantified the wearables sales discreetly. I think the best way to think about it is we did see a sequential improvement coming out of the first half, and in the third quarter we did see a bit more of a step-down in the traditional business, mainly in Europe, a little bit here in North America. So it's really the change in that trajectory is being driven by the sell-in in wearables in the third quarter, and that pattern based on our guidance should roughly repeat in the fourth quarter. You see the guidance where we could be from a fairly small headwind to a little bit of a tailwind in the fourth quarter. Again, that trajectory is largely driven by our ability to sell in wearables and get some reorders without any significant further erosion in the base business.

Operator

Erinn Murphy, Piper Jaffray.

Erinn Murphy ***Piper Jaffray & Co. - Analyst***

You guys mentioned there were some just modest delays in getting some of the wearables shipped. Are you seeing that tied to a specific brand, is it a specific component? And then what was that dollar shift from Q4 into Q1 that you are anticipating?

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

I would describe it as very modest delays especially considering the scope and scale of what we launched. Imagine this is a pretty new business to us. We had to integrate Misfit and all the engineers. Our entire Company has been working on this from supply chain to sourcing, distribution, planning. I'd say all in all, the amount of delays was surprisingly low and not a big impact on our financials.

Operator

Ed Yruma, KeyBanc Capital Markets.

Edward Yruma ***KeyBanc Capital Markets - Analyst***

You guys did a leaseback on the distribution center. You sold some excess real estate. How should we think about liquidity and availability on liquidity as you do this restructuring and as you're repositioning your business? Thank you.

Dennis Secor ***Fossil Group, Inc. - CFO***

I'd tell you that the entire organization has been very focused on making sure that we have ample capital available to us to run the business. If you remember last quarter, we announced that we amended our credit facility to give us substantially more access to our existing revolver. The entire organization has been very focused on managing resources very tightly. Our inventories are down in the quarter and down significantly in the traditional watch business, which is helping us to invest in wearables. We don't typically like to be in the real estate business, and when we do, we like to look for opportunities to realize sizable gains which we were able to do with the sale and leaseback of the distribution center here in Dallas, and we used those funds to repay some of our debt which we've said is a priority for us this year. We are very focused on that. We have good access to capital and liquidity and we feel we are in good shape to execute our plan.

Operator

Heather Balsky, Bank of America.

Heather Balsky ***BofA Merrill Lynch - Analyst***

Thank you for taking my question. My first question is going back to your profitability improvement initiative. It sounds like a number of aspects of it could involve additional spending, things that a lot of other retailers right now are investing heavily in, and I am just curious how you thought about spending over the next few years to realize the longer-term improvements? And then on a separate point, could you just talk about -- Asia grew this quarter, what you kind of saw in the environment, what do you think drove that improvement? Thanks.

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Dennis Secor ***Fossil Group, Inc. - CFO***

Let me step back on New World Fossil. It's early days. There's a lot of different aspects and moving parts to this. We have got a pretty good line of sight into anticipated store closures. There's a lot of work left to be done with all the efforts that Kosta enumerated just a few minutes ago. So we are going to be able to share more details as we go through time and learn more and share more with you. Where we are right now is that our analysis suggests that over that period of time, we could be investing about $150 million over a multiple-year program and that we think that could generate from where we are right now an additional $200 million of operating income when we reach maturity in the program. We will tell you more as we go, but there's not a lot more detail to share right now.

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

As far as Asia goes, yes, we were very pleased to see us getting increases there. We have seen over the last couple years, as you know, I think the market has been somewhat dormant, especially in China. We have seen growth in India over the past couple years, and that's continued, but we are gratified to see that we're increasing spending and sellthrough in the market. We do think that wearables can turbo charge that to a certain degree, and we're looking forward to seeing some results of that in the fourth quarter. But this gets back to our original plan, which was -- there's still over the next 10 years, there's going to be hundreds of millions of people joining the middle class in Asia, and we are participating and putting resources in place to capture that customer as it comes to market, and it should be a huge long-term opportunity for us.

Operator

Betty Chen, Mizuho Securities.

Betty Chen ***Mizuho Securities - Analyst***

Thanks for taking our question. I wanted to -- Dennis, if you can talk a little more about channel inventory. Certainly, it seems like on your balance sheet, the inventory is quite healthy and you mentioned a lot of it has declined in the traditional watch segment. How do you feel about the channel inventory with the step-down at department stores and also what you seeing in the off-price as well as outlet? Thanks.

Dennis Secor ***Fossil Group, Inc. - CFO***

Yes, I mean we feel certainly our own inventories, as we mentioned, are in really good shape. We monitor particularly in the US where we have the best visibility and we track sell-in versus sellthrough and we feel that those have been pretty well aligned, so we're not anticipating significant channel adjustments in terms of the level of inventory that's out there right now.

Operator

Scott Krasik, Buckingham Research.

Scott Krasik ***Buckingham Research Group - Analyst***

Thanks for taking my questions. It's important if you could just give us -- I know you don't want to talk a lot about New World Fossil but just some idea of what the cash component potentially of the $150 million would be. And then, one thing that came out on Fitbit's call is that this business is becoming more and more seasonal, maybe even more seasonal than your leathers or traditional watch business. So as we think to next year, are you already planning for that and maybe the lumpiness of what that might mean in how you introduce new products, et cetera? Thanks.

Dennis Secor ***Fossil Group, Inc. - CFO***

As I said just a moment ago, we will share more about New World Fossil as we learn more, specifically to how much cash will there be of the $150 million. I don't have a specific number to share with you other than the way we are thinking about it is we're assuming that a substantial amount of that is cash. But again, we will learn more, we'll know more a quarter from now when we are talking about 2017 guidance as well, and we will be able to share more. As we learn, we will communicate what we know.

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

Part of our strategy in terms of timing is the idea of fashion brands and storytelling is creating new products all during the year that customers get excited about and to broaden out the selling, so it's not just during the holiday season. So that's part of the strategy, and we'll see how it plays out. We had an extremely strong sellthrough over the last couple of months, and this is a really slow time of the

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year. So that was great to see, and we'll see how it plays out in December during the holiday season.

The other thing to keep in mind is that typically the watch business overall, before wearables was even around, the watch business, about 45% of it, the sales were between Thanksgiving and Christmas. We hear that wearables is even skewed even more heavily towards that, maybe even 50% or so, but it's not that much different than our typical watch business.

Operator

Dana Telsey, Telsey Advisory.

Dana Telsey ***Telsey Advisory - Analyst***

As you think about the reinvention of Fossil, what should be the guideposts that we watch for to say, here is the progress being made? And what does it mean in terms of distribution channels and your initial thoughts on how that is changing, product categories and thoughts on how that's changing, and geography? Thank you.

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

So the objective is to look at our core strength, so design and branding capabilities, distribution and supply chain, our overall scale, our position in the marketplace, our unique culture, and also now with the acquisition of Misfit, our technology capabilities which give us extremely enhanced capabilities for innovation and differentiation. To look at all those pieces and take holistic view of the entire Company and figure out how can we operate quicker, get to market quicker with better storytelling, better products, and really invest more, be as efficient and as lean as we possibly can, and invest more behind our key initiatives. Just like we've done with wearables and omnichannel the last couple years, but really do it in a more holistic end-to-end way throughout the entire Company.

Operator

Anna Andreeva, Oppenheimer.

Anna Andreeva ***Oppenheimer Capital - Analyst***

Good afternoon, guys. A question on fourth-quarter guide. I think you mentioned early indications in watches are encouraging. Should we think you are currently tracking toward the high end or the low end of the sales guide? And then secondly on production delays, have you rectified those or could there still be some impact into 2017? Thanks.

Dennis Secor ***Fossil Group, Inc. - CFO***

The guide for the fourth quarter, I'm not following your point. I would view it right now you have got the majority of the important selling season still in front of us. We view that as a range of outcomes. It is difficult to predict where we fall within that. As we've said before, the last quarter and the same exists now, we see three principal risks, further erosion in the traditional business, some execution on wearables, and getting the reorders that we're anticipating, and additional margin pressure if that becomes necessary to drive some additional business. So most of the quarter is still in front of us. And November and December is when the bulk of the business is going to be done. So we still view it as very much a range right now.

Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

On the delay side, I would say again, it's very modest. I wouldn't say it's any better or worse than our typical product categories that we've now had for a number of years.

Greg McKelvey ***Fossil Group, Inc. - Chief Strategy and Digital Officer***

To add a little more color over that, the root issue there was we're fortunately in some ways just oversubscribed relative to our initial product volume. So we went into a short allocation period. It especially impacted international. So we've caught up and are rolling the product through right now.

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Kosta Kartsotis ***Fossil Group, Inc. - Chairman & CEO***

The one thing I would say about this that is very good is that our entire wholesale base of customers, 30,000 points of sale globally, are all very excited about getting the products in and they want more, and the sellthroughs have been strong. So we're in a situation where we're chasing goods, especially for -- we've exceeded by a long shot our demand for Michael Kors. So we're chasing goods right now, which is always the best situation you could ever be in.

Operator

Laurent Vasilescu, Macquarie.

Laurent Vasilescu ***Macquarie Research Equities - Analyst***

Can you parse out in more detail the $0.38 charge anticipated for 4Q? Can we see an inventory write-down on traditional watches? And then secondly, with the Burberry and Adidas business unwinding next year, I think that's a mid-single-digit top-line headwind that goes away for FY18. And then Karl Lagerfeld contract is up for renewal. How should we think high level about the top line for next year?

Dennis Secor ***Fossil Group, Inc. - CFO***

Yes. So with respect to the restructuring charges in the fourth quarter, that is largely driven by the leased the real estate and store closures. And as we said in the prepared remarks, right now we sort of view that as sort of a worst case, if you will, because there's still a lot of work to be done and that is largely dependent upon the timing of those negotiations. Some of them are in flight right now. Some of them haven't begun. So we kind of wanted to provide that number, but give you some indication that some of it could slip into the first quarter if we don't fully execute. With respect to 2017, we're not yet guiding to 2017, although there's still -- the contracts that you mentioned are still in effect next year. So we will still have sales for those brands in 2017, but we'll talk more about 2017 on the next call.

Operator

I'm showing no further questions at this time. I'd like to turn the call back over to Dennis Secor for closing remarks.

Dennis Secor ***Fossil Group, Inc. - CFO***

Great. Thank you very much. I just wanted to quickly come back to one point on fourth-quarter guidance. Our sales guidance range for the fourth quarter is a decrease of 2% to an increase of 4%. I believe I stated 5% in the prepared remarks, so the information in our press release is correct.

So with that, thank you again for joining us today. We look forward to speaking to you again on the next earnings call, which will be in February and we can update on the performance of our second-gen wearables and highlight some of the progress we're making on the New World Fossil initiative. Thank you very much.

Operator

Ladies and gentlemen, this concludes today's conference. Thanks for your participation and have a wonderful day.

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