

GUESS INC
Form 10-K
March 01, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

**x Annual Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934**

For the Fiscal Year Ended December 31, 2006

OR

**o Transition Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934**

For the transition period from to

Commission File Number 1-11893

GUESS?, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

1444 South Alameda Street

Los Angeles, California 90021

(213) 765-3100

(Address, including zip code, and telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class

common stock, par value \$0.01 per share

Securities registered pursuant to Section 12(g) of the Act: None

**Name of Each Exchange
on Which Registered**

New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

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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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of the close of business on July 1, 2006, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the voting and non-voting common equity stock held by non-affiliates of the registrant was \$977,882,152 based upon the closing price of \$20.88 on the New York Stock Exchange composite tape on such date (as adjusted to reflect the two-for-one stock split announced on February 14, 2007). For this computation, the registrant has excluded the market value of all shares of its common stock reported as beneficially owned by executive officers and directors of the registrant. Such exclusion shall not be deemed to constitute an admission that any such person is an affiliate of the registrant.

As of the close of business on February 20, 2007, the registrant had 93,198,238 shares of common stock outstanding.

DOCUMENTS INCOPORATED BY REFERENCE

Portions of the proxy statement for the registrant's 2007 Annual Meeting of Stockholders are incorporated by reference into Part III herein.

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IMPORTANT FACTORS REGARDING FORWARD-LOOKING STATEMENTS

Throughout this Annual Report on Form 10-K, including documents incorporated by reference herein, we make forward-looking statements, which are not historical facts, but are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may also be in the Company's other reports filed under the Securities Exchange Act of 1934, in its press releases and in other documents. In addition, from time to time, the Company, through its management, may make oral forward-looking statements. These statements relate to analyses and other information based on forecasts of future results and estimates of amounts not yet determinable. These statements also relate to our future prospects and proposed new products, services, developments or business strategies. These forward-looking statements are identified by their use of terms and phrases such as anticipate, believe, could, estimate, expect, intend, may, plan, will, continue, and other similar terms and phrases, including references to assumptions.

Although we believe that the expectations reflected in any of our forward-looking statements are reasonable, actual results could differ materially from those projected or assumed. These forward-looking statements may include, among other things, statements relating to the Company's expected results of operations, the accuracy of data relating to, and anticipated levels of, future inventory and gross margins, anticipated cash requirements and sources, cost containment efforts, estimated charges, plans regarding store openings and closings, plans regarding business growth, plans regarding international expansion, e-commerce, business seasonality, industry trends, consumer demands and preferences, competition and general economic conditions. We do not intend, and undertake no obligation, to update our forward-looking statements to reflect future events or circumstances. Such statements involve risks and uncertainties, which may cause actual results to differ materially from those set forth in these statements. Important factors that could cause or contribute to such difference include those discussed under Item 1A. Risk Factors contained herein.

RECENT EVENTS

On January 18, 2007, the Board of Directors of Guess?, Inc. (the Company) approved a change in the Company's fiscal year end from December 31 to the Saturday nearest January 31 of each year. The fiscal year change is effective beginning with the Company's 2008 fiscal year, which began February 4, 2007 and will end February 2, 2008. As a result of the change, the Company had a January 2007 fiscal month transition period which began January 1, 2007 and ended February 3, 2007. The results of the transition period are expected to be reported in the Company's Form 10-Q to be filed for the new fiscal first quarter ending May 5, 2007 and in the Company's Form 10-K to be filed for the new fiscal year ending February 2, 2008. Because the fiscal year change was not effective until after the completion of the Company's 2006 fiscal year, the financial and other information reported herein continues to be reported based on the Company's prior fiscal calendar.

On February 12, 2007, the Board of Directors declared a quarterly cash dividend of \$0.12 per share (on a pre-split basis) on the Company's common stock and approved a two-for-one stock split of the Company's common stock to be effected in the form of a 100% stock dividend. The cash dividend and the 2007 stock split will each be paid on or about March 12, 2007 to shareholders of record as of the close of business on February 26, 2007. The Company's common stock is expected to begin trading on the New York Stock Exchange on a post-split basis on March 13, 2007. All historical share and per share amounts in this Annual Report on Form 10-K have been adjusted to reflect the 2007 Stock Split.

PART I

ITEM 1. Business.

General

Unless the context indicates otherwise, the terms we, us or the Company in this Form 10-K, are referring to Guess?, Inc. (GUESS?) and its subsidiaries on a consolidated basis.

We design, market, distribute and license one of the world's leading lifestyle collections of contemporary apparel and accessories for men, women and children that reflect the American lifestyle and European fashion sensibilities. Our apparel is marketed under numerous trademarks including GUESS, GUESS?, GUESS U.S.A., GUESS Jeans, GUESS? and Triangle Design, Question Mark and Triangle Design, a stylized G, GUESS Kids, Baby GUESS, YES, G by GUESS, GUESS by MARCIANO and MARCIANO. The lines include full collections of denim and cotton clothing, including jeans, pants, overalls, skirts, dresses, shorts, blouses, shirts, jackets and knitwear. We also selectively grant licenses to manufacture and distribute a broad range of products that complement our apparel lines, including eyewear, watches, handbags, footwear, kids and infants' apparel, leather apparel, swimwear, fragrance, jewelry and other fashion accessories.

Our products are sold through three primary distribution channels: in our own stores, to a network of wholesale accounts and through the Internet. GUESS? branded products, some of which are produced under license, are also sold internationally through a series of licensees and distributors. Our core customer is a style-conscious consumer primarily between the ages of 18 and 32. These consumers are part of a highly desirable demographic group that we believe has significant disposable income. We also appeal to customers outside this group through specialty product lines that include MARCIANO, a more sophisticated fashion line targeted to women, and GUESS Kids, targeted to boys and girls ages six to twelve.

We were founded in 1981 and currently operate as a Delaware corporation.

Business Segments

The business segments of the Company are retail, wholesale, European and licensing. The Company believes this segment reporting reflects how its four business segments are managed and each segment's performance is evaluated. The retail segment includes the Company's retail operations in North America. The wholesale segment includes the wholesale operations in North America and internationally, excluding Europe. The European segment includes both wholesale and retail operations in Europe. The licensing segment includes the worldwide licensing operations of the Company. The business segments' results exclude corporate overhead costs, which consist of shared costs of the organization. These costs are presented separately and generally include, among other things, the following corporate costs: information technology, human resources, accounting and finance, executive compensation, facilities and legal. Financial information about each segment, together with certain geographical information, for the fiscal years ended December 31, 2006, 2005 and 2004 are included under Note 15 to the Consolidated Financial Statements contained herein.

In 2006, 60.9% of our net revenue was generated from retail operations, 12.3% from wholesale operations, 21.3% from European operations and 5.5% from licensing operations. Our total net revenue in 2006 was \$1.19 billion and net earnings were \$123.2 million.

Business Strengths

We believe we have several business strengths which help us to successfully execute our strategies. These business strengths include:

1

Brand Equity. We believe that our brand name is one of the most familiar in fashion and is one of our most valuable assets. We believe the enduring strength of the GUESS? brand name and image is due mainly to our consistent emphasis on innovative and distinctive product designs that stand for exceptional styling and quality. Our industry is highly competitive and subject to rapidly changing consumer preferences and tastes. The success of our brand depends on our ability to anticipate the fashion preferences of our customers. We have a team of designers who, under the direction of Maurice Marciano, our Chairman, seeks to identify global fashion trends and interpret them for the style-conscious consumer while retaining the distinctive GUESS? image. Through our award-winning advertising, under the creative leadership and vision of Paul Marciano, our Chief Executive Officer, we have achieved worldwide recognition of the GUESS? brand name. By retaining control over advertising and marketing activities from our headquarters in Los Angeles, we maintain the integrity, consistency and direction of the GUESS? brand image worldwide, while realizing substantial cost savings when compared to the use of outside advertising agencies.

We have developed the GUESS? signature image and GUESS? lifestyle concept through the use of our strong and distinctive images, merchandising display themes, logos and trademarks which are registered in approximately 170 countries.

Advertising and Marketing. We control all of our worldwide advertising, marketing activities and promotional materials from our headquarters in Los Angeles. GUESS Jeans, GUESS U.S.A. and GUESS?, Inc. images have been showcased globally in dozens of major publications as well as in outdoor and broadcast media.

We communicate the GUESS? image through the use of our signature black and white print advertisements, as well as color print advertisements, designed by our in-house advertising department. Led by Paul Marciano, this team has won numerous awards and contributed to making the GUESS? brand one of the most recognizable fashion brands in the world. We have maintained a high degree of consistency in our advertisements by using similar themes and images. We require our licensees and distributors to invest a percentage of their net sales of licensed products and net purchases of GUESS? products in Company-approved advertising, promotion and marketing.

Retail Distribution. At December 31, 2006, we operated a total of 336 stores in the U.S. and Canada, consisting of 192 full-price retail stores, 103 factory outlet stores, 25 MARCIANO stores and 16 Guess Accessories stores. At year end, we also operated 24 stores in Europe and three stores in Mexico through a majority owned joint venture. Our retail network creates an upscale and inviting shopping environment and enhances our image. Distribution through our retail stores allows us to influence the merchandising and presentation of our products, build brand equity and test market new product design concepts. Our retail stores carry a full assortment of men's and women's merchandise, including most of the GUESS? licensed products. Our factory outlet stores are primarily located in outlet malls generally operating outside the shopping radius of our wholesale customers and our own full-price retail stores.

In 2004, we launched our MARCIANO product line. This line was previously labeled as GUESS Collection and was rebranded as MARCIANO in the third quarter of 2004. The new assortment commands higher price points and it targets a more upscale, contemporary customer. The MARCIANO line is available in approximately half of our full-price GUESS? retail stores in the U.S. and Canada. As of December 31, 2006, we had 25 MARCIANO stores that feature this line exclusively.

In 2004, we also launched a new Accessories store concept. We believe we offer unique positioning in the accessories marketplace with a well-recognized brand name at a more accessible price point than the luxury accessories brands. As of December 31, 2006, we had 16 Accessories stores that carry the full GUESS? accessories line. We continue to sell accessories in our full-price retail and factory outlet stores, and through our licensees. Our accessories are also available in department stores and internationally.

Licensee Stores. Our international licensees and distributors operated 386 GUESS? stores in approximately 57 countries outside the U.S. and Canada at December 31, 2006. We plan to open approximately 108 new stores in 2007 primarily through our international licensees and distributors. These stores carry apparel and accessories that are similar to those sold in the U.S., including some that are tailored for local fashion sensibilities. We work closely with international licensees and distributors to ensure that their store designs and merchandise programs protect the reputation of the GUESS? trademarks. Our international licenses and distribution agreements also allow for the sale of GUESS? brand products in better department stores and upscale specialty retail stores.

Wholesale Distribution. We have both domestic and international wholesale distribution channels. U.S. wholesale customers consist primarily of better department stores and select specialty retailers and upscale boutiques, which have the image and merchandising expertise that we require for the effective presentation of our products. Leading U.S. wholesale customers include Federated Department Stores, Inc. and Dillard's, Inc. At December 31, 2006, our products were sold directly to consumers from approximately 970 doors in the U.S. These locations include 398 shop-in-shops, an exclusive selling area within a department store that offers a wide array of our products and incorporates GUESS? signage and fixture designs. These shop-in-shops allow us to reinforce the GUESS? brand image with our customers. Many department stores have more than one shop-in-shop, with each one featuring women's or men's apparel. Through our foreign subsidiaries and our network of international distributors, our products are also found in major cities throughout Africa, Asia, Australia, Europe, the Middle East, North America and South America.

Licensing Operations. The desirability of the GUESS? brand name among consumers has allowed us to selectively expand our product offerings and global markets through trademark licensing arrangements, with minimal capital investment or on-going operating expenses. We carefully select our trademark licensees and approve in advance all product design, advertising and packaging materials of all licensed products in order to maintain a consistent GUESS? image. We currently have 21 domestic and international licenses that include eyewear, watches, handbags, footwear, kids and infants apparel, lingerie, leather outerwear, fragrance, jewelry and other fashion accessories. We have granted licenses for the manufacture or sale of GUESS? branded products in markets which include Africa, Asia, Australia, Europe, the Middle East, North America and South America.

European Operations. We run our European business with our local European management team who work closely with our wholesale customers, licensees and distributors and also manage our owned stores. Following the acquisition of our European jeanswear licensee in January 2005, we integrated this business with our existing European accessories business. In addition, effective December 31, 2006, the Company acquired 75% of the outstanding shares of Focus Europe, S.r.l. (Focus), the Company's existing licensee for the manufacture, distribution and retail sales of GUESS by MARCIANO contemporary apparel in Europe, the Middle East and Asia. The acquisition is expected to further accelerate the Company's expansion in Europe. While the GUESS? brand is well recognized in Europe, we believe it is under-penetrated and we see significant opportunities to expand distribution. In 2006, we, along with our licensees and distributors, opened 42 stores of all retail concepts combined in Europe. At the end of 2006, Guess and its licensees and distributors operated 102 stores in Europe, 24 of which were Company operated. In 2007, we plan to open approximately 35 stores in Europe primarily through our licensees and distributors.

Business Growth Strategies

We regularly evaluate and implement initiatives that we believe will build brand equity, grow our business and enhance profitability. Our key growth strategies are as follows:

Leveraging the GUESS? Brand. We believe the GUESS? brand is an integral part of our business, a significant strategic asset and a primary source of sustainable competitive advantage. It communicates a

distinctive image that is fun, fashionable and sexy. Brand loyalty, name awareness, perceived quality, strong brand images, public relations, publicity, promotional events and trademarks all contribute to brand integrity. Our design teams visit the world's premier fashion locations in order to identify important style trends and to discover new fabrics. We will continue this practice while promoting our innovative designs through stylish advertising campaigns that advance the GUESS? image. Our marketing programs are designed to convey a uniform style image for the brand and are aimed at increasing the desire of the target group to join our GUESS? customer group.

Retail Store Strategy and Expansion Plans. Our retail growth strategy is to increase retail sales and profitability by expanding our network of retail stores and improving the performance of existing stores. During 2006, we opened a total of 32 new stores in the U.S. and Canada consisting of eight new full-price retail stores, seven factory outlet stores, 11 MARCIANO stores and six GUESS Accessories stores, while closing 11 stores.

Our retail locations build brand awareness and contribute to market penetration and growth of the brand in concert with our wholesale operations. In 2006, we increased our retail average square footage by 5.3% to 1,621,000 square feet in the U.S. and Canada. We continue to be very selective with new store locations and expect to open approximately 48 new stores in 2007, consisting of 15 full-price retail, four factory outlet, 13 MARCIANO, three GUESS Accessories and 13 G by GUESS stores. In addition, we plan to close approximately 18 stores and convert 19 stores to G by GUESS stores in 2007. The Company is also exploring a joint venture arrangement with its footwear licensee to open a small number of new footwear concept stores in North America.

In 2006, total sales in the U.S. and Canada at our stores open for at least one year increased by 12.8% from 2005 levels. We believe this increase is attributable to our commitment to several ongoing initiatives, including leadership in new product development, a more fashion-focused product mix, the introduction of new product categories, improvements in merchandising and visual presentation, the remodeling of select stores to promote a consistent brand image, an improved retail store inventory allocation system, the continued development of the MARCIANO and Accessories lines and the development of a motivated team of sales professionals to service our customers and provide a favorable shopping experience.

We are also placing additional emphasis on our Accessories line and our MARCIANO line. This includes greater focus on these products in our existing stores as well as continuing to develop and open additional Accessories and MARCIANO stores which exclusively feature these products.

During 2006, we opened 11 MARCIANO and six Guess Accessories stores in addition to the nine and six stores that we opened in 2005, respectively. These store concepts leverage our brand recognition and the reputation we have for sexy, contemporary styling to extend the appeal of our brand. The MARCIANO brand is attracting a slightly older, more sophisticated customer, while the Accessories stores are enabling us to build a more meaningful presence in this high-margin segment. We are targeting customers who already shop GUESS? stores but are looking for an expanded accessories presentation, as well as new customers who did not shop at GUESS? in the past.

As part of our retail growth strategy, in 2007 we are launching our new mid-tier brand store concept, which we call G by GUESS. G by GUESS is aimed to capture a market demographic that shops price points between factory and retail. The G by GUESS brand will only be distributed in G by GUESS stores and will carry apparel for both men and women that is aspirational, timeless and fun. The stores will have a fresh feel, directed toward a full customer experience, with fashion-forward, but not cutting edge fashion. The stores will have a slightly smaller footprint than Guess? stores. We will be rolling out G by GUESS in early 2007 in North America. We expect to convert some Guess? and factory stores and also open some new stores, resulting in approximately 32 G by GUESS stores by year end.

International Expansion. International expansion continues to be a key to our long term growth strategy. In January 2005, we completed the acquisition of the remaining 90% of Maco, the Italian licensee

of GUESS jeanswear for men and women in Europe, including the assets and leases of ten retail stores in Europe. In 2006, we, along with our distributors and licensees, opened 125 stores in all concepts combined outside of the U.S. and Canada, bringing the total number of such stores to 413 at year end. In addition, effective December 31, 2006, the Company acquired 75% of the outstanding shares of Focus Europe, S.r.l. (Focus), the Company's existing licensee for the manufacture, distribution and retail sales of GUESS by MARCIANO contemporary apparel in Europe, the Middle East and Asia. The acquisition is expected to further accelerate the Company's expansion in Europe.

We believe there are significant opportunities to continue our international growth, particularly in Europe, where the GUESS? brand is well recognized but under-penetrated, as well as in Mexico, India, the Middle and the Far East. In South Korea, we began selling directly in approximately 45 points of sales in 2007 including concessions which are owned and operated by us through leasing spaces from major department stores, as well as franchised stores. We opened a showroom in Hong Kong in 2006 and plan to open approximately 20 points of sales in China during 2007, with flagship stores in Beijing and Shanghai, as well as free standing stores in Hong Kong and Macau. In addition, our new joint venture in Mexico is currently distributing through a major department store chain, Liverpool, with 22 shop-in-shop locations and has opened three stand-alone stores.

Our business will also grow as our partners open new licensed stores internationally. We plan to open approximately 108 new retail stores in 2007 outside the U.S. and Canada primarily through our international licensees and distributors. We are working closely with our international distributors and licensees to develop these opportunities and to expand the availability of the GUESS? brand throughout the world.

Continue to Develop Licensee Portfolio. One of our primary objectives is to maintain the quality and reputation of the GUESS? brand. In order to accomplish this goal, we will continue to strategically reposition our licensing portfolio by constantly monitoring and evaluating the performance of our licensees worldwide and their strength and capabilities to appropriately represent our brand. As part of this process, we will consider bringing in-house apparel licenses, where appropriate, or license lines which we produce as we did with our kids business in 2001. If we determine that licensees are performing inadequately, we will, from time to time, discontinue the existing relationship and seek out a stronger replacement licensee.

In 2006, we entered into a joint venture with Adivina S.A. de. C.V. to oversee the revitalization and expansion of the GUESS? brand in Mexico; we also signed a new license with a European licensee to develop and manufacture lingerie and swimwear under the GUESS? trademark in Europe and certain other countries. In 2005, we successfully renegotiated license agreements with our existing licensees for watches, handbags and eyewear on terms that were significantly improved over our prior arrangements and began shipping our new fragrance line. In addition, in 2004, we signed a new shoe license with Marc Fisher LLC to develop, manufacture, and distribute athletic and fashion footwear under the GUESS? trademark in the U.S. and several countries worldwide and began shipping footwear products in 2005. We believe these are important steps in expanding our presence both domestically and globally. We will continue to strategically examine opportunities to expand our licensee portfolio by developing new licensees that can expand our brand penetration and complement the GUESS? image.

Acquisition Strategy. We evaluate strategic acquisitions and alliances and pursue those that we believe will support and contribute to our overall growth initiatives. In December 2006, we acquired 75% of the outstanding shares of Focus, as well as the leases and assets of four retail stores in Italy. Focus, based in Italy, has served as the licensee, manufacturer, distributor and retailer of GUESS by MARCIANO contemporary apparel for men and women in Europe for the past 10 years. The agreement included the purchase of inventory, certain fixed assets and the transfer of leases for the retail locations.

In January 2005, we completed the acquisition of the remaining 90% of Maco Apparel, S.p.A. (Maco), the Italian licensee of GUESS jeanswear for men and women in Europe, that the Company did

not already own from Fingen S.p.A. and Fingen Apparel N.V., as well as the assets and leases of ten retail stores in Europe. The agreement included the purchase of inventory and receivables, the assumption of certain liabilities, and the transfer of leases for the GUESS retail locations. The stores are located in Rome, Milan, Paris, Amsterdam, London, and certain other European cities.

With the Focus and Maco acquisitions, we now directly manage our adult apparel businesses in Europe. We believe the combination of the manufacture and distribution of all our European apparel lines under the GUESS? umbrella allows us to take advantage of economies of scale and provides an opportunity to further expand our wholesale and retail operations in this region.

Improved Product Sourcing. Over the past year, we initiated significant changes within our supply chain operations: re-defining calendars, streamlining processes and building core competencies within our product areas. These new processes are providing calendar alignment and timely delivery to our western hemisphere retail and wholesale divisions, while also incorporating the development calendars and market timing of our Asian and European businesses. This globalization of operations will enable us to begin integrating our European, North American and Asian-based supply chains. This, in turn, supports our long term strategy of developing a global core product assortment, through collaboration between our U.S. and Italy based design teams. To better support the design process, we formed a new Product Development team responsible for driving calendar deadlines, assortment plans and financial goals throughout the design process. In addition, this team is responsible for fabric research and development, working directly with global textile mills and suppliers, in order to drive innovation, ensure quality and increase value within our product lines. We are currently developing a Product Lifecycle Management (PLM) system that will enable global access and centralized management for our newly defined processes and calendars. Initial roll-out is scheduled for early 2007 with enhancement and refinement to continue throughout 2007, providing comprehensive management of all product related activities from concept to distribution.

In 2006, we significantly increased the sourcing volume placed through our own Hong Kong sourcing office. In 2006, we purchased approximately 89% of our North American finished products from third-party international vendors, primarily in Asia and Mexico. In 2007, we plan to build product development and pre-manufacturing capabilities within, in addition to adding depth to, our existing Asian based sourcing staff. These investments should enable us to shift early stage conceptual development and product engineering to Asia, facilitating closer collaboration with our key suppliers from design inception. Los Angeles will remain the hub of denim development and production, as well as speed-based development and wholesale replenishment program management.

Logistics. The Company's primary distribution center is based in Louisville, Kentucky. This 506,000 square-foot facility is near United Parcel Service's national transit hub and has contributed to the reduction of our shipping time to our stores and wholesale accounts that are east of the Mississippi River. Depending on processing volumes and productivity improvements, we expect that we will continue to reduce operating cost per unit by reducing handling costs in the Kentucky facility and will provide better service to our customers by faster shipping and reduced response times. As of December 31, 2006, this facility was approximately 50% utilized.

We continued to focus on all aspects of our supply chain in 2006. For example, we are planning to implement a new picking system to be completed in 2007 which should reduce our picking costs for merchandise. In the first quarter of 2005, we opened a new warehouse and distribution facility in Montreal, Quebec to replace our existing facility there, and we updated our software systems in our Montreal and Los Angeles warehouse and distribution facilities to be consistent with the software systems used in our primary Kentucky facility. In 2004, we installed an automated product sorter machine in the Kentucky distribution center which has resulted in operating efficiencies. These systems, along with other actions we are taking, should result in lower processing and freight costs in the future.

E-Commerce. Our websites, www.guess.com, www.guessfactory.com, www.marciano.com and www.guess.ca are virtual storefronts that promote our brands. Designed as customer shopping centers, these sites showcase our products in an easy-to-navigate format, allowing customers to see and purchase our collections of casual apparel and accessories. Not only have these virtual stores become an additional retail distribution channel, but also they have improved customer service and are fun and entertaining alternative-shopping environments. These sites also provide fashion information, provide a mechanism for customer feedback, promote customer loyalty and enhance our brand identity through interactive content. In 2006, these combined sites experienced growth and generated net sales in excess of the top retail GUESS? store in the chain.

GUESS? Products

We derive net revenue from four primary sources: the sale of our men's and women's apparel, and the sale of our licensees' products, through our network of retail and factory outlet stores in the U.S. and Canada; the sale of GUESS? men's and women's apparel and certain accessories to wholesale customers and distributors in North America and the rest of the world except Europe; the sale of GUESS? men's and women's apparel and certain accessories to wholesale customers and through our owned stores in Europe; and royalties from worldwide licensing activities.

The following table sets forth our net revenue from our business segments:

	Year Ended December 31, 2006		2005		2004	
	(dollars in thousands)					
Net revenue:						
Retail operations	\$ 721,262	60.9 %	\$ 612,862	65.5 %	\$ 518,855	71.1 %
Wholesale operations	146,320	12.3	121,103	12.9	120,392	16.5
European operations	252,363	21.3	153,817	16.4	42,773	5.9
Net revenue from product sales	1,119,945	94.5	887,782	94.8	682,020	93.5
Licensing operations	65,239	5.5	48,310	5.2	47,242	6.5
Total net revenue	\$ 1,185,184	100.0 %	\$ 936,092	100.0 %	\$ 729,262	100.0 %

Products. Our product line is organized into two primary categories: women's and men's apparel. To take advantage of contemporary trends, we complement our core basic styles with more fashion-oriented items. We add new styles, treatments and finishes to our denim assortment on a continuous basis.

Our line of women's apparel also includes the MARCIANO product line, a full collection of better women's apparel incorporating a sophisticated, high fashion combination of colors and styles. These products currently are sold primarily through our GUESS? retail stores, our MARCIANO stores and our www.marciano.com website. We continue to believe this product line has significant potential and will continue to focus on increasing penetration in the marketplace.

Licensed Products. The high level of desirability of the GUESS? brand among consumers has allowed us to selectively expand our product offerings and distribution channels worldwide through trademark licensing arrangements. We currently have 21 trademark licenses. Worldwide sales of licensed products (as reported to us by our licensees) were approximately \$753 million in 2006. We recorded net royalties of \$65.2 million in 2006. Approximately 71% of our net royalties were derived from our top five licensees in 2006.

Design

Under the direction of Maurice Marciano, GUESS?, G by GUESS and MARCIANO products are designed by an in-house staff of three design teams (men's, women's, G by Guess and MARCIANO) located in Los Angeles, California and an in-house design team based in Florence, Italy. The U.S. and European teams work closely to share ideas and develop products that can sell in both markets. Our design teams travel throughout the world in order to monitor fashion trends and discover new fabrics. Fabric shows in Europe, Asia and the U.S. provide additional opportunities to discover and sample new fabrics. These fabrics, together with the trends observed by our designers, serve as the primary source of inspiration for our lines and collections. We also maintain a fashion library consisting of antique and contemporary garments as another source of creative concepts. In addition, our design teams regularly meet with members of the sales, merchandising and retail operations teams to further refine our products to meet the particular needs of our markets.

U.S. and Canada Retail Operations

At December 31, 2006, our North American retail operations, which includes owned stores in both the U.S. and Canada, consisted of 192 full-price retail, 103 factory outlet, 25 MARCIANO, and 16 Accessories stores which sell GUESS? and MARCIANO-labeled products. Below is a summary of store statistics as of December 31, 2006, 2005 and 2004.

	December 31, 2006	2005	2004
Retail stores:			
U.S.	149	152	150
Canada	43	39	36
	192	191	186
Factory stores:			
U.S.	89	85	75
Canada	14	14	11
	103	99	86
MARCIANO:			
U.S.	18	9	4
Canada	7	5	1
	25	14	5
Accessories:			
U.S.	12	11	6
Canada	4		
	16	11	6
Kids stores:			4
Total	336	315	287
Square footage at year end	1,621,000	1,563,000	1,460,000
Sales per average annual square foot	\$ 447	\$ 401	\$ 369

Retail Stores. At December 31, 2006, our full price North American retail stores occupied approximately 957,000 square feet and ranged in size from approximately 2,000 to 13,500 square feet, with most stores between 3,000 and 6,000 square feet. Our retail stores carry a full assortment of men's and women's GUESS? merchandise, including most of our licensed products. In addition, approximately half of our full-price GUESS? retail stores offer our MARCIANO line that is carried almost exclusively in our company operated stores. In 2006, we opened eight new retail stores and closed seven stores. Sales

per square foot for our full price North American retail stores, not including factory outlet or new concept stores, increased from \$395 in 2005 to \$432 in 2006.

Factory Outlet Stores. At December 31, 2006, our North American factory outlet stores occupied approximately 568,000 square feet and ranged in size from approximately 3,400 to 10,700 square feet, with most stores between 4,000 and 6,500 square feet. They are primarily located in outlet malls generally operating outside the shopping radius of our wholesale customers and our full-price retail stores. These stores sell selected styles of GUESS? apparel and licensed products at a discount to value-conscious customers. We also use the factory outlet stores to liquidate excess inventory and thereby protect the GUESS? image. In 2006, we opened seven new factory stores and closed three stores. Sales per square foot for our North American factory outlet stores increased from \$398 in 2005 to \$446 in 2006.

MARCIANO Stores. At December 31, 2006, our MARCIANO stores occupied approximately 68,000 square feet and ranged in size from approximately 1,500 to 5,100 square feet, with most stores between 2,000 and 3,000 square feet. In 2006, we opened eleven MARCIANO stores. We continue to monitor the performance of this store concept carefully. This concept leverages the name recognition of the MARCIANO brand and the reputation we have for sexy, contemporary styling to extend the appeal of our brand. The MARCIANO brand is attracting a slightly older, more sophisticated customer. Sales per square foot for our MARCIANO stores decreased from \$721 in 2005 to \$704 in 2006 due primarily to new stores opened during the year.

Accessories Stores. At December 31, 2006, our Accessories concept stores occupied approximately 28,000 square feet and ranged in size from approximately 700 to 3,200 square feet, with most stores between 1,000 and 2,500 square feet. In 2006, we opened six Accessories stores and closed one Accessories store. The Accessories stores are enabling us to build a more meaningful presence in this high-margin segment. Sales per square foot for our Accessories stores increased from \$432 in 2005 to \$602 in 2006.

International Business

We derive net revenue and earnings outside the U.S. and Canada from three principal sources: (a) sales of GUESS? brand apparel directly to our international distributors who distribute it to better department stores, upscale specialty retail stores and GUESS?-licensed retail stores operated by our international distributors, (b) sales of GUESS? and GUESS by MARCIANO branded apparel by the Company through its owned and operated retail stores and (c) royalties from licensees who manufacture and distribute GUESS? branded products outside the U.S. GUESS? products are sold through distributors and licensees throughout Africa, Asia, Australia, Europe, the Middle East, North America and South America.

At December 31, 2006, our licensees and distributors operated internationally (outside the U.S. and Canada) 386 GUESS? retail and outlet stores. Our retail store license agreements generally provide detailed guidelines for store fixtures and merchandising programs. The appearance, merchandising and service standards of these stores are closely monitored to ensure that our image and brand integrity are maintained. We plan to open approximately 108 new retail stores in 2007 outside the U.S. and Canada primarily through our international licensees and distributors. We also owned and operated 24 GUESS? retail stores in Europe and three GUESS? retail stores through a majority owned joint venture in Mexico at December 31, 2006. In 2006, our European operations accounted for 21.3% of our total net revenues, up from 16.4% in 2005.

While the GUESS? brand is well recognized in Europe, we believe it is under-penetrated and we see significant opportunities to expand distribution. Effective December 31, 2006, the Company acquired 75% of the outstanding shares of Focus Europe, S.r.l. (Focus), the Company's existing licensee for the manufacture, distribution and retail sales of GUESS by MARCIANO contemporary apparel in Europe,

the Middle East and Asia. The acquisition is expected to further accelerate the Company's expansion in Europe.

Domestic Wholesale Customers

Our domestic wholesale customers consist primarily of better department stores and select specialty retailers and upscale boutiques, which have the image and merchandising expertise that we require for the effective presentation of our products. Leading domestic wholesale customers include Federated Department Stores, Inc. and Dillard's, Inc. During 2006, our products were sold directly to consumers through approximately 970 doors in the U.S. Our wholesale merchandising strategy is to focus on trend-right products supported by key fashion basics.

We have sales representatives in New York and Los Angeles. They coordinate with customers to determine the inventory level and product mix that should be carried in each store to maximize retail sell-throughs and enhance the customers' profit margins. The inventory level and product mix are then used as the basis for developing sales projections and product needs for each wholesale customer and for scheduling production. Additionally, we use merchandise coordinators who work with the stores to ensure that our products are displayed appropriately.

A few of our domestic wholesale customers, including some under common ownership, have accounted for significant portions of our net revenue. During 2006, Bloomingdale's, Macy's and other affiliated stores owned by Federated Department Stores, Inc. were our largest domestic wholesale customers and together accounted for approximately 5.5% of our consolidated net revenue. During 2006, we continued to see our domestic wholesale operations become a smaller proportion of our overall business as our international businesses expanded. In 2006, our domestic wholesale operations accounted for 8.5% of our total net revenues, down from 9.0% in 2005.

License Agreements and Terms

Our trademark license agreements customarily provide for a three- to five-year initial term with a possible option to renew prior to expiration for an additional multi-year period. In addition to licensing trademarks for products which complement our apparel products, we have granted trademark licenses for the manufacture and sale of GUESS® branded products similar to ours, including men's and women's denim and knitwear, in markets such as Europe, the Philippines, South Africa and Mexico. Licenses granted to certain licensees that have produced high-quality products and have demonstrated solid operating performance, such as for GUESS® watches, GUESS® handbags and GUESS® eyewear, have been renewed and in some cases expanded to include new products or markets. In other cases, products that were formerly licensed, such as our women's knits line, are now being produced in-house. The typical license agreement requires that the licensee pay us the greater of a royalty based on a percentage of the licensee's net sales of licensed products or a guaranteed annual minimum royalty that typically increases over the term of the license agreement. In addition, several of our key license agreements provide for specified, fixed cash rights payments over and above our normal, ongoing royalty payments. Generally, licensees are required to spend a percentage of the net sales of licensed products for advertising and promotion of the licensed products and in many cases we place the ads on behalf of the licensee and are reimbursed. In addition, to protect and increase the value of our trademarks, our license agreements include strict quality control and manufacturing standards.

Our licensing personnel in the U.S., Italy and Hong Kong meet regularly with licensees to ensure consistency with our overall merchandising and design strategies, to monitor quality control and to protect the GUESS® trademark and brand. The licensing department approves in advance all GUESS® licensed products, advertising, promotional and packaging materials.

Advertising and Marketing

Our advertising, public relations and marketing strategy is designed to promote a consistent high impact image which endures regardless of changing consumer trends. Since our inception, Paul Marciano has had principal responsibility for the GUESS? brand image and creative vision. All worldwide advertising and promotional material is controlled through our advertising department based in Los Angeles. GUESS Jeans, GUESS U.S.A. and GUESS?, Inc. images have been showcased globally in dozens of major publications as well as in outdoor and broadcast media.

Our advertising strategy promotes the GUESS? image and products, with an emphasis on brand image. Our signature black and white print advertisements, as well as color print advertisements, have garnered prestigious awards, including Clio, Belding and Mobius awards for creativity and excellence. These awards, which we have received on numerous occasions in our history, are generally given based on the judgment of prominent members of the advertising industry. We have maintained a high degree of consistency in our advertisements, using similar themes and images. We require our licensees and distributors to invest a percentage of their net sales of licensed products and net purchases of GUESS? products in approved advertising, promotion and marketing.

Our advertising department is responsible for all worldwide advertising, which includes approval of all advertising strategies and media placements from our licensees and distributors. We use a variety of media with an emphasis on print and outdoor advertising. We have focused advertisement placement in national and international contemporary fashion/beauty, lifestyle, and celebrity magazines including Vanity Fair, Marie Claire, Elle, W and Vogue. By retaining control over our advertising programs, we are able to maintain the integrity of our brands while realizing substantial cost savings compared to outside agencies.

We further strengthen communications with customers through our websites (www.guess.com, www.guessfactory.com, www.marciano.com, www.gbyguess.com and www.guess.ca). These global media enable us to provide timely information in an entertaining fashion to consumers about our history, products and store locations, and allow us to receive and respond directly to customer feedback.

Sourcing and Product Development

We do not own any production facilities or equipment. We source products through numerous suppliers, many of whom have established long-term relationships with us. We seek to achieve the most efficient means for timely delivery of our products. To remain competitive, in recent years we have increasingly sourced our finished products globally. During 2006, we sourced approximately 89% of our finished products from third-party suppliers located outside the U.S. Most of these finished products are acquired as package purchases where we supply the design and fabric selection and the vendor delivers the finished product. Although we have long-term relationships with many of our vendors, we do not have long-term written agreements with them.

Sources and Availability of Raw Materials

Our products use a variety of raw materials, principally consisting of woven denim, woven cotton and knitted fabrics and yarns. Historically, we make commitments for a significant portion of our fabric well in advance of sales.

Quality Control

Our quality control program is designed to ensure that products meet our high quality standards. We monitor the quality of our fabrics prior to the production of garments and inspect prototypes of each product before production runs commence. We also perform random in-line quality control checks during and after production before the garments leave the contractor. Final random inspections occur when the

garments are received in our distribution centers. We believe that our policy of inspecting our products at our distribution centers and at the vendors' facilities is important to maintain the quality, consistency and reputation of our products.

Distribution Centers

We utilize distribution centers at strategically located sites. Until 1999, distribution of our products in the U.S. was centralized in our facility in Los Angeles, California, which we operate and lease from a related party. In January 2000, we opened an automated distribution center in Louisville, Kentucky, to replace the distribution center in Los Angeles as our primary distribution center. Distribution of our products in Canada is handled from a distribution center in Montreal, Quebec that we also lease from a related party. Our European business utilizes an independent distributor with two separate locations in Italy, which services Europe. Additionally, we utilize a contract warehouse in Hong Kong that services the Pacific Rim.

At our distribution center in Kentucky, we use fully integrated and automated distribution systems. The bar code scanning of merchandise, picking tickets and distribution cartons, together with radio frequency communications, provide timely, controlled, accurate and instantaneous updates to the distribution information systems. As of December 31, 2006, this facility was approximately 50% utilized. We continue to monitor our distribution center integration as our business grows and the center matures.

Competition

The apparel industry is highly competitive and fragmented, and is subject to rapidly changing consumer demands and preferences. We believe that our success depends in large part upon our ability to anticipate, gauge and respond to changing consumer demands and fashion trends in a timely manner and upon the continued appeal to consumers of the GUESS? brand. We compete with numerous apparel manufacturers and distributors, both domestically and internationally, as well as several well-known designers, including some that have recently entered or re-entered the designer denim market. Our retail and factory outlet stores face competition from other retailers, including some of our major wholesale customers. Our licensed apparel and accessories also compete with a substantial number of designer and non-designer lines and various other well-known brands. Many of our competitors, including The Gap, Abercrombie & Fitch, DKNY and Polo Ralph Lauren, among others, have greater financial resources than we do. Although the level and nature of competition differ among our product categories and geographic regions, we believe that we compete on the basis of our brand image, quality of design, workmanship and product assortment.

Information Systems

We believe that high levels of automation and technology are essential to maintain our competitive position and support our strategic objectives and we continue to invest in computer hardware, system applications and networks. Our computer information systems consist of a full range of financial, distribution, merchandising, in-store, supply chain and other systems. During 2006, we implemented new financial and operational systems in Europe to accommodate future growth and provide operating efficiencies. In addition, a new data warehouse and reporting system was implemented to provide enhanced merchandise and analytical reporting. We are currently developing a PLM system to integrate our global supply chain.

Trademarks

We own numerous trademarks, including GUESS, GUESS?, GUESS U.S.A., GUESS Jeans, GUESS? and Triangle Design, MARCIANO, Question Mark and Triangle Design, a stylized G and a

stylized M, Baby GUESS, YES, G by GUESS, GUESS by MARCIANO and GUESS Collection. As of December 31, 2006, we had approximately 2,300 U.S. and internationally registered trademarks or trademark applications pending with the trademark offices in approximately 170 countries around the world, including the U.S. From time to time, we adopt new trademarks in connection with the marketing of new product lines. We consider our trademarks to have significant value in the marketing of our products and act aggressively to register and protect our trademarks worldwide.

Like many well-known brands, our trademarks are subject to infringement. We have staff devoted to the monitoring and aggressive protection of our trademarks worldwide.

Wholesale Backlog

The backlog of wholesale orders at any given time is affected by various factors, including seasonality, cancellations, the scheduling of market weeks and manufacturing and shipment of products. Accordingly, a comparison of backlogs of wholesale orders from period to period is not necessarily meaningful and may not be indicative of eventual actual shipments.

U.S. backlog. The Company maintains a model stock program in its basic denim products which generally allows replenishment of a customer's inventory within 48 hours. The Company generally receives orders for fashion apparel 90 to 120 days prior to the time the products are delivered to stores. Regarding our U.S. wholesale backlog, the scheduling of market weeks can affect the amount of orders booked in the backlog compared to the same date in the prior year. This year's backlog for product, as an example, reflected a longer shipping period of about three months for women's product and one month of men's product compared to last year's backlog. We estimate that if we were to exclude the additional orders from this year's backlog to make the comparison consistent with the prior year, then the current backlog would be up about 11.1% from the prior year. Not taking into account the impact of this change, our U.S. wholesale backlog as of February 17, 2007, consisting primarily of orders for fashion apparel, was approximately \$55.5 million, compared to \$35.3 million for such orders at February 18, 2006, or up 57.2%.

Europe backlog. Our European business operates with two primary wholesale selling seasons. The Spring/Summer season, which ships mostly in January, February and March and the Fall/Winter season, which ships mostly in July, August and September. Generally, the other months are relatively small shipping months. However, customers have the ability to request early shipment of backlog orders or delay shipment of orders depending on their needs. Accordingly, a certain amount of orders in the backlog may be shipped outside of the traditional shipping months. As of February 17, 2007, the European operations backlog was approximately \$143.7 million. This includes backlog related to the Focus acquisition. The backlog comprises sales orders for both the Spring/Summer and Fall/Winter seasons. As discussed above, these orders are subject to cancellation and may not be indicative of eventual actual shipments.

Employees

We strongly believe that our employees (associates) are our most valuable resources. As of January 19, 2007, we had approximately 8,800 associates, including approximately 7,500 associates in our retail operations, 600 in our wholesale operations and 500 in our European operations.

Except for approximately 21 employees in Italy who are represented by labor unions, none of our associates are represented by labor unions and we are not a party to any labor agreements. We consider our relationship with our associates to be good.

Initiation of Quarterly Dividend and Approval of Stock Split

On February 12, 2007, the Board of Directors of the Company declared a quarterly cash dividend of \$0.12 per share on the Company's common stock and approved a two-for-one stock split of the Company's

common stock, each to be paid on or about March 12, 2007 to shareholders of record as of the close of business on February 26, 2007. Because the record date for the initial cash dividend preceded the March 12, 2007 stock split distribution date, the cash dividend will be paid on only pre-split shares. Assuming the Board of Directors maintains the current level of cash dividends, future quarterly dividends per share will be half the current level but will apply to shares on a post split basis. The payment of cash dividends in the future will be at the discretion of our Board of Directors and will be based upon a number of business, legal and other considerations, including our cash flow from operations, capital expenditures, debt service requirements, cash paid for income taxes, earnings and liquidity.

Environmental Matters

We are subject to federal, state and local laws, regulations and ordinances that govern activities or operations that may have adverse environmental effects (such as emissions to air, discharges to water, and the generation, handling, storage and disposal of solid and hazardous wastes). We are also subject to laws, regulations and ordinances that impose liability for the costs of clean up or other remediation of contaminated property, including damages from spills, disposals or other releases of hazardous substances or wastes, in certain circumstances without regard to fault. Certain of our operations routinely involve the handling of chemicals and wastes, some of which are or may become regulated as hazardous substances. We have not incurred, and do not expect to incur, any significant expenditures or liabilities for environmental matters. As a result, we believe that our environmental obligations will not have a material adverse effect on our consolidated financial condition or results of operations.

Financial Information About Geographic Areas

See Note 15 to the Consolidated Financial Statements for a discussion regarding our domestic and foreign operations.

Website Access to Our Periodic SEC Reports

We make available free of charge at www.guessinc.com our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished to the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after we electronically file them with, or furnish them to, the SEC. In addition, the charters of our Board of Directors Audit, Compensation and Nominating and Governance Committees as well as the Board of Directors Governance Guidelines and our Code of Conduct are posted on our website. We may from time to time provide important disclosures to our investors, including amendments or waivers to our Code of Conduct, by posting them in the Investor's Info section of the Guess?, Inc. portion of the website, as allowed by SEC rules. Printed copies of these documents may be obtained by writing or telephoning us at Guess?, Inc., 1444 South Alameda Street, Los Angeles, California 90021, Attention: Investor Relations, (213) 765-5578.

ITEM 1A. Risk Factors.

You should carefully consider the following factors and other information in this Annual Report or Form 10-K. Additional risks which we do not presently consider material, or of which we are not currently aware, may also have an adverse impact on us. Please also see Important Factors Regarding Forward-Looking Statements on page (ii).

Demand for our merchandise may decrease and the appeal of our brand image may diminish if we fail to identify and rapidly respond to consumers' fashion tastes.

The apparel industry is subject to rapidly evolving fashion trends and shifting consumer demands. Accordingly, our brand image and our profitability are heavily dependent upon both the priority our target

customers place on fashion and on our ability to anticipate, identify and capitalize upon emerging fashion trends. Current fashion tastes place significant emphasis on a fashionable look. In the past this emphasis has increased and decreased through fashion cycles. If we fail to anticipate, identify or react appropriately, or in a timely manner, to fashion trends, we could experience reduced consumer acceptance of our products, a diminished brand image and higher markdowns. These factors could result in lower selling prices and sales volumes for our products and could have a material adverse effect on our results of operations and financial condition.

The apparel industry is highly competitive, and we may face difficulties competing successfully in the future.

We operate in a highly competitive and fragmented industry with low barriers to entry. We compete with many apparel manufacturers and distributors, both domestically and internationally, as well as many well-known designers, some of whom have substantially greater resources than we do and some of whose products are priced lower than ours. Our retail and factory outlet stores compete with many other retailers, including department stores, some of whom are our major wholesale customers. Our licensed apparel and accessories compete with many designer and non-designer lines and well-known brands. Within each of our geographic markets, we also face significant competition from global and regional branded apparel companies, as well as retailers that market apparel under their own labels. These and other competitors pose significant challenges to our market share in our existing major domestic and foreign markets. In addition, our larger competitors may be better able than we to adapt to changing conditions that affect the competitive market. Also, the industry's low barriers to entry allows the introduction of new products or new competitors at a faster pace. Any of these factors could result in reductions in sales or prices of our products and could have a material adverse effect on our results of operations and financial condition.

Changes in the economy and trends in consumer confidence may adversely affect the fashion industry as well as our operating results.

The industry in which we operate is cyclical. Purchases of apparel and related merchandise tend to decline during recessionary periods and also may decline at other times. Reduced levels of consumer spending can also result from (i) changes in interest rates, (ii) the availability of consumer credit, (iii) changes in taxation rates, (iv) consumer confidence in future economic conditions and (v) reduced levels of consumer disposable income. Due to these cyclical factors in the retail industry, we may not be able to maintain our growth in revenues or earnings, or remain profitable in the future.

Actual or potential terrorist acts and other conflicts in recent periods have also created significant instability and uncertainty in the world and may have additional effects in the future. These may include causing consumers to defer purchases or preventing our suppliers and service providers from providing required services or materials to us. These or other impacts could materially and adversely affect our operating results.

We could find that we are carrying excess inventories if we fail to anticipate consumer demand, if our international vendors do not supply quality products on a timely basis, if our merchandising strategies fail or if we do not open new and remodel existing stores on schedule.

Even if we correctly anticipate consumer fashion trends, our vendors could fail to supply the quality products and materials we require at the time we need them. Moreover, we could fail to effectively market or merchandise these products once we receive them. Lastly, we could fail to open new or remodeled stores on schedule, and inventory purchases made in anticipation of such store openings could remain unsold. Any of the above factors could cause us to experience excess inventories and higher markdowns, which in turn could have a material adverse effect on our results of operations and financial condition.

Our success depends on maintaining good working relationships with our suppliers and manufacturers.

We do not own or operate any production facilities equipment, and we depend on independent contractors to supply our fabrics and to manufacture our products to our specifications. We do not have long-term contracts with any suppliers or manufacturers, and our business is dependent on continued good relations with our vendors. In addition, none of our suppliers or manufacturers supplies or manufactures our products exclusively. As a result, we compete with other companies for the production capacity of independent manufacturers and international import quota capacity. If our vendors or manufacturers fail to ship our fabrics or products on time or to meet our quality standards or are unable to fill our orders, we might not be able to deliver products to our retail stores and wholesale customers on time or at all.

Moreover, our manufacturers have at times been unable to deliver finished products in a timely fashion. This has led, from time to time, to an increase in our inventory, creating potential markdowns and a resulting decrease in our profitability. As there are a limited number of qualified, offshore manufacturers, it could take significant time to find alternative manufacturers, which could result in our missing retailing seasons or our wholesale customers canceling orders, refusing to accept deliveries or requiring that we lower selling prices. Since we cannot return merchandise to our manufacturers, we could also have a significant amount of unsold merchandise. Any of these problems could harm our financial condition and results of operations.

Our wholesale business is highly concentrated. The decision by any of our large customers to decrease their purchases of our products or stop carrying our products could have a material adverse effect on our results of operations and financial condition.

In 2006, 5.5% of our consolidated net revenue came from Bloomingdale's, Macy's and other affiliated stores owned by Federated Department Stores, Inc. No other single customer or group of related customers accounted for more than 5% of our net revenue in 2006. Continued consolidation in the retail industry could further decrease the number of, or concentrate the ownership of, stores that carry our and our licensees products. Also, as we expand the number of our retail stores, we run the risk that our wholesale customers will perceive that we are increasingly competing directly with them, which may lead them to reduce or terminate purchases of our products. In addition, in recent years there has been a significant increase in the number of designer brands seeking placement in department stores, which makes any one brand potentially less attractive to department stores. If any one of our major customers decides to decrease purchases from us, to stop carrying GUESS? products or to carry our products only on terms less favorable to us, our sales and profitability could significantly decrease. This could have a material adverse effect on our results of operations and financial condition.

Since we do not control our licensees' actions and we depend on our licensees for a substantial portion of our earnings from operations, their conduct could harm our business.

We license to others the rights to produce and market products that are sold with our trademarks. If the quality, focus, image or distribution of our licensed products diminish, consumer acceptance of and demand for the GUESS? brand and products could decline. This could materially and adversely affect our business and results of operations. In 2006, approximately 71% of our net royalties were derived from our top five licensed product lines. A decrease in customer demand for any of these product lines could have a material adverse effect on our results of operations and financial condition.

We depend on our intellectual property, and our methods of protecting it may not be adequate.

Our success and competitive position depend significantly upon our trademarks and other proprietary rights. We take steps to establish and protect our trademarks worldwide. Despite any precautions we may take to protect our intellectual property, policing unauthorized use of our intellectual property is difficult, expensive and time consuming, and we may be unable to adequately protect our intellectual property or to determine the extent of any unauthorized use, particularly in those foreign countries where the laws do not protect proprietary rights as fully as in the United States. We also place significant value on our trade dress and the overall appearance and image of our products. However, we cannot assure you that we can prevent imitation of our products by others or prevent others from seeking to block sales of GUESS? products for violating their trademarks and proprietary rights. We also cannot assure you that others will not assert rights in, or ownership of, trademarks and other proprietary rights of GUESS?, that our proprietary rights would be upheld if challenged or that we would, in that event, not be prevented from using our trademarks, any of which could have a material adverse effect on our financial condition and results of operations. Further, we could incur substantial costs in legal actions relating to our use of intellectual property or the use of our intellectual property by others. Even if we are successful in such actions, the costs we incur could have a material adverse effect on us.

If we fail to successfully execute our growth initiatives, including through acquisitions, our business and results of operations could be harmed.

As part of our business growth initiatives, we regularly open new stores in the United States and Canada. We also regularly evaluate strategic acquisitions and alliances and pursue those that we believe will support and contribute to our overall growth initiatives. For instance, we completed the acquisition of our former European jeanswear licensee during 2005 and the acquisition of 75% of the outstanding shares of our former European licensee of the GUESS by MARCIANO contemporary line of apparel for women and men in December 2006. We have also continued our international expansion by opening new stores outside the U.S., primarily in the form of stores owned by our international licensees and distributors. We plan to continue opening new stores in the U.S. and internationally. This expansion effort places increased demands on our managerial, operational and administrative resources that could prevent or delay the successful opening of new stores, adversely impact the performance of our existing stores and adversely impact our overall results of operations. In addition, acquired businesses may not provide us with increased business opportunities, or result in the growth that we anticipate. Furthermore, integrating acquired operations is a complex, time-consuming and expensive process. Failing to acquire and successfully integrate complementary businesses, or failing to achieve the business synergies or other anticipated benefits of acquisitions,