

PHILLIPS VAN HEUSEN CORP /DE/
Form 10-Q
December 08, 2006

SECURITIES & EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended October 29, 2006

OR

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 001-07572

PHILLIPS-VAN HEUSEN CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

13-1166910

(IRS Employer
Identification No.)

200 Madison Avenue New York, New York 10016

(Address of principal executive offices)

Registrant's telephone number (212) 381-3500

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 requirement for the past 90 days.

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of outstanding shares of common stock, par value \$1.00 per share, of the registrant as of November 27, 2006 was 55,533,290.

PHILLIPS-VAN HEUSEN CORPORATION

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SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995: Forward-looking statements in this Quarterly Report on Form 10-Q including, without limitation, statements relating to our future revenues and earnings, plans, strategies, objectives, expectations and intentions, are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Investors are cautioned that such forward-looking statements are inherently subject to risks and uncertainties, many of which cannot be predicted with accuracy, and some of which might not be anticipated, including, without limitation, the following: (i) our plans, strategies, objectives, expectations and intentions are subject to change at any time at our discretion; (ii) the levels of sales of our apparel, footwear and related products, both to our wholesale customers and in our retail stores, and the levels of sales of our licensees at wholesale and retail, and the extent of discounts and promotional pricing in which we and our licensees and other business partners are required to engage, all of which can be affected by weather conditions, changes in the economy, fuel prices, reductions in travel, fashion trends, consolidations, repositionings and bankruptcies in the retail industries, repositioning of brands by our licensors and other factors; (iii) our plans and results of operations will be affected by our ability to manage our growth and inventory, including our ability to continue to realize revenue growth from developing and growing Calvin Klein; (iv) our operations and results could be affected by quota restrictions and the imposition of safeguard controls (which, among other things, could limit our ability to produce products in cost-effective countries that have the labor and technical expertise needed), the availability and cost of raw materials (particularly petroleum-based synthetic fabrics, which are currently in high demand), our ability to adjust timely to changes in trade regulations and the migration and development of manufacturers (which can affect where our products can best be produced), and civil conflict, war or terrorist acts, the threat of any of the foregoing, or political and labor instability in the United States or any of the countries where our products are or are planned to be produced; (v) disease epidemics and health related concerns, which could result in closed factories, reduced workforces, scarcity of raw materials and scrutiny or embargoing of goods produced in infected areas; (vi) acquisitions and issues arising with acquisitions and proposed transactions, including without limitation, the ability to integrate an acquired entity into us with no substantial adverse affect on the acquired entity's or our existing operations, employee relationships, vendor relationships, customer relationships or financial performance; (vii) the failure of our licensees to market successfully licensed products or to preserve the value of our brands, or their misuse of our brands; and (viii) other risks and uncertainties indicated from time to time in our filings with the Securities and Exchange Commission.

We do not undertake any obligation to update publicly any forward-looking statement, including, without limitation, any estimate regarding revenues, earnings or cash flows, whether as a result of the receipt of new information, future events or otherwise.

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

We have reviewed the condensed consolidated balance sheets of Phillips-Van Heusen Corporation as of October 29, 2006 and October 30, 2005, the related condensed consolidated income statements for the thirteen and thirty-nine week periods ended October 29, 2006 and October 30, 2005 and the related condensed consolidated statements of cash flows for the thirty-nine week periods ended October 29, 2006 and October 30, 2005. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated interim financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Phillips-Van Heusen Corporation as of January 29, 2006, and the related consolidated income statement, statement of changes in stockholders' equity, and statement of cash flows for the year then ended (not presented herein) and in our report dated March 20, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of January 29, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

ERNST & YOUNG LLP

New York, New York

November 20, 2006

Phillips-Van Heusen Corporation

Condensed Consolidated Balance Sheets

(In thousands, except share and per share data)

| | October 29, <u>2006</u> | January 29, <u>2006</u> | October 30, <u>2005</u> |
|--|----------------------------|----------------------------|----------------------------|
| | <u>UNAUDITED</u> | <u>AUDITED</u> | <u>UNAUDITED</u> |
| ASSETS | | | |
| Current Assets: | | | |
| Cash and cash equivalents | \$ 358,602 | \$ 267,357 | \$ 170,265 |
| Accounts receivable, net of allowances for doubtful accounts of \$5,431, \$3,111 and \$3,659 | 168,742 | 96,757 | 189,679 |
| Inventories | 280,762 | 257,719 | 262,874 |
| Prepaid expenses | 10,794 | 18,122 | 8,698 |
| Other, including deferred taxes of \$23,435, \$23,435 and \$13,666 | <u>23,603</u> | <u>23,693</u> | <u>13,969</u> |
| Total Current Assets | 842,503 | 663,648 | 645,485 |
| Property, Plant and Equipment, net | 157,689 | 158,492 | 155,566 |
| Goodwill | 221,068 | 199,999 | 193,860 |
| Tradenames | 612,966 | 612,966 | 612,930 |
| Perpetual License Rights | 86,000 | 86,000 | 86,000 |
| Other Intangible Assets | 375 | 420 | 435 |
| Other Assets | <u>24,308</u> | <u>25,914</u> | <u>29,448</u> |
| Total Assets | <u>\$1,944,909</u> | <u>\$1,747,439</u> | <u>\$1,723,724</u> |
| LIABILITIES AND STOCKHOLDERS EQUITY | | | |
| Current Liabilities: | | | |
| Accounts payable | \$ 74,693 | \$ 61,596 | \$ 57,358 |
| Accrued expenses | 156,427 | 145,269 | 142,648 |
| Deferred revenue | <u>16,954</u> | <u>17,751</u> | <u>17,164</u> |
| Total Current Liabilities | 248,074 | 224,616 | 217,170 |
| Long-Term Debt | 399,535 | 399,525 | 399,522 |
| Other Liabilities, including deferred taxes of \$265,704, \$232,484 and \$233,141 | 393,916 | 350,710 | 381,665 |

Series B convertible preferred stock, par value \$100 per share;

6,116 shares authorized, issued and outstanding as of January 29, 2006

and October 30, 2005 - 161,926 161,926

Stockholders Equity:

Preferred stock, par value \$100 per share; 150,000 total shares

authorized, including Series B convertible (125,000 shares designated as Series A; 25,000; 18,884 and 18,884 shares undesignated); no Series A or undesignated shares issued

- - -

Common stock, par value \$1 per share; 240,000,000 shares authorized; shares issued and outstanding 55,500,599;

43,236,485 and 42,230,640 55,501 43,236 42,231

Additional capital 517,971 346,061 317,664

Retained earnings 363,877 255,360 235,671

Accumulated other comprehensive loss (33,965) (33,995) (32,125)

Total Stockholders Equity 903,384 610,662 563,441

Total Liabilities and Stockholders Equity \$1,944,909 \$1,747,439 \$1,723,724

See accompanying notes.

Phillips-Van Heusen Corporation

Condensed Consolidated Income Statements

Unaudited

(In thousands, except per share data)

| | <u>Thirteen Weeks Ended</u> | | <u>Thirty-Nine Weeks Ended</u> | |
|--|-----------------------------|----------------------------|--------------------------------|----------------------------|
| | October 29, <u>2006</u> | October 30, <u>2005</u> | October 29, <u>2006</u> | October 30, <u>2005</u> |
| Net sales | \$500,235 | \$471,778 | \$1,361,543 | \$1,292,451 |
| Royalty revenues | 52,037 | 47,559 | 130,384 | 117,059 |
| Advertising and other revenues | <u>15,989</u> | <u>13,844</u> | <u>41,700</u> | <u>39,249</u> |
| Total revenues | 568,261 | 533,181 | 1,533,627 | 1,448,759 |
| Cost of goods sold | <u>287,880</u> | <u>283,935</u> | <u>783,375</u> | <u>779,963</u> |
| Gross profit | 280,381 | 249,246 | 750,252 | 668,796 |
| Selling, general and administrative expenses | 195,738 | 177,638 | 564,148 | 504,437 |
| Gain on sale of investment | <u>-</u> | <u>-</u> | <u>32,043</u> | <u>-</u> |
| Income before interest and taxes | 84,643 | 71,608 | 218,147 | 164,359 |
| Interest expense | 8,568 | 8,600 | 25,699 | 25,772 |
| Interest income | <u>4,645</u> | <u>1,351</u> | <u>11,798</u> | <u>3,217</u> |
| Income before taxes | 80,720 | 64,359 | 204,246 | 141,804 |
| Income tax expense | <u>29,947</u> | <u>24,070</u> | <u>75,775</u> | <u>53,035</u> |
| Net income | 50,773 | 40,289 | 128,471 | 88,769 |
| Preferred stock dividends on convertible stock | - | 3,229 | - | 9,688 |
| Preferred stock dividends on converted stock | - | - | 3,230 | 2,051 |
| Inducement payments and offering costs | <u>-</u> | <u>-</u> | <u>10,948</u> | <u>14,205</u> |

| | | | | |
|---|------------------|------------------|-------------------|------------------|
| Net income available to common stockholders | <u>\$ 50.773</u> | <u>\$ 37.060</u> | <u>\$ 114.293</u> | <u>\$ 62.825</u> |
| Basic net income per common share | <u>\$ 0.92</u> | <u>\$ 0.88</u> | <u>\$ 2.24</u> | <u>\$ 1.71</u> |
| Diluted net income per common share | <u>\$ 0.89</u> | <u>\$ 0.73</u> | <u>\$ 2.19</u> | <u>\$ 1.44</u> |
| Dividends declared per common share | <u>\$ 0.0375</u> | <u>\$ 0.075</u> | <u>\$ 0.1125</u> | <u>\$ 0.15</u> |

See accompanying notes.

Phillips-Van Heusen Corporation

Condensed Consolidated Statements of Cash Flows

Unaudited

(In thousands)

| | <u>Thirty-Nine Weeks Ended</u> | |
|--|--------------------------------|----------------------------|
| | October 29, <u>2006</u> | October 30, <u>2005</u> |
| OPERATING ACTIVITIES: | | |
| Net income | \$128,471 | \$ 88,769 |
| Adjustments to reconcile to net cash provided by operating activities: | | |
| Depreciation | 23,923 | 23,143 |
| Amortization | 3,430 | 2,851 |
| Deferred taxes | 36,366 | 45,942 |
| Stock-based compensation | 5,707 | - |
| Impairment of long-lived assets | 3,418 | - |
| Gain on sale of investment, net | (32,043) | - |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (71,985) | (96,232) |
| Inventories | (23,043) | (19,989) |
| Accounts payable, accrued expenses and deferred revenue | 23,458 | 8,677 |
| Prepaid expenses | 7,328 | 10,277 |
| Other, net | <u>7,411</u> | <u>18,776</u> |
| Net Cash Provided By Operating Activities | <u>112,441</u> | <u>82,214</u> |
| INVESTING ACTIVITIES: | | |
| Purchase of property, plant and equipment | (26,380) | (24,648) |
| Contingent purchase price payments to Mr. Calvin Klein | (21,069) | (19,342) |
| Proceeds from sale of investment, net | <u>32,811</u> | <u>-</u> |
| Net Cash Used By Investing Activities | <u>(14,638)</u> | <u>(43,990)</u> |
| FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options | 10,277 | 39,601 |
| Excess tax benefits from exercise of stock options | 3,119 | - |
| Acquisition of treasury shares | - | (69) |
| Common stock dividends | (5,776) | (5,661) |

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| | | |
|--|------------------|------------------|
| Convertible preferred stock dividends | - | (9,688) |
| Converted preferred stock dividends | (3,230) | (2,051) |
| Inducement payment and offering costs | <u>(10,948)</u> | <u>(14,205)</u> |
| Net Cash (Used) Provided By Financing Activities | <u>(6,558)</u> | <u>7,927</u> |
| | | |
| Increase in cash | 91,245 | 46,151 |
| | | |
| Cash at beginning of period | <u>267,357</u> | <u>124,114</u> |
| | | |
| Cash at end of period | <u>\$358,602</u> | <u>\$170,265</u> |

See accompanying notes.

PHILLIPS-VAN HEUSEN CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollar and share amounts in thousands, except per share data)

1. GENERAL

The Company's fiscal years are based on the 52-53 week period ending on the Sunday closest to February 1, and are designated by the calendar year in which the fiscal year commences.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not contain all disclosures required by accounting principles generally accepted in the United States for complete financial statements. Reference should be made to the audited consolidated financial statements, including the notes thereto, included in the Company's Annual Report on Form 10-K as amended for the fiscal year ended January 29, 2006.

The preparation of interim financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from the estimates.

The results of operations for the thirteen and thirty-nine weeks ended October 29, 2006 and October 30, 2005 are not necessarily indicative of those for a full fiscal year due, in part, to seasonal factors. The data contained in these financial statements are unaudited and are subject to year-end adjustments. However, in the opinion of management, all known adjustments (which consist only of normal recurring accruals) have been made to present fairly the consolidated operating results for the unaudited periods.

Certain reclassifications have been made to the condensed consolidated financial statements and the notes thereto for the prior year periods to present that information on a basis consistent with the current year.

References to the brand names *Calvin Klein Collection*, *ck Calvin Klein*, *Calvin Klein*, *Van Heusen*, *IZOD*, *Arrow*, *Bass*, *Eagle*, *Geoffrey Beene*, *BCBG Max Azria*, *BCBG Attitude*, *Chaps*, *Sean John*, *Donald J. Trump Signature*

Collection, Kenneth Cole New York, Kenneth Cole Reaction, unlisted, A Kenneth Cole Production, JOE Joseph Abboud and MICHAEL Michael Kors, and to other brand names in these Notes are to registered trademarks owned by the Company or licensed to the Company by third parties and are identified by italicizing the brand name.

2. INVENTORIES

Inventories related to the Company's wholesale operations, comprised principally of finished goods, are stated at the lower of cost or market. Inventories related to the Company's retail operations, comprised entirely of finished goods, are stated at the lower of average cost or market using the retail inventory method. Under the retail inventory method, the valuation of inventories at cost is calculated by applying a cost-to-retail ratio to the retail value of inventories. Permanent and point of sale markdowns, when recorded, reduce both the retail and cost components of inventory on hand so as to maintain the already established cost-to-retail relationship. Cost for certain apparel and accessory inventories is determined using the last-in, first-out method (LIFO). Cost for all other inventories is determined using the first-in, first-out method (FIFO). At October 29, 2006, January 29, 2006 and October 30, 2005, no LIFO reserves were recorded because LIFO cost approximated FIFO cost.

3. GOODWILL

The changes in the carrying amount of goodwill for the period ended October 29, 2006, by segment, were as follows:

| | Wholesale Dress <u>Shirt</u> | Wholesale Sportswear and Related <u>Products</u> | Calvin Klein <u>Licensing</u> | <u>Total</u> |
|--|------------------------------------|---|----------------------------------|------------------|
| Balance as of January 29, 2006 | \$9,946 | \$82,133 | \$107,920 | \$199,999 |
| Contingent purchase price payments to Mr. Calvin Klein | <u>-</u> | <u>-</u> | <u>21,069</u> | <u>21,069</u> |
| B a l a n c e a s o f O c t o b e r 2 9 , 2 0 0 6 | <u>\$9,946</u> | <u>\$82,133</u> | <u>\$128,989</u> | <u>\$221,068</u> |

As of January 29, 2006 and October 29, 2006, no goodwill was associated with the Retail Apparel and Related Products segment or the Retail Footwear and Related Products segment.

In connection with the Company's acquisition of Calvin Klein, Inc. and certain affiliated companies (Calvin Klein) in February 2003, the Company is obligated to pay contingent purchase price payments to Mr. Calvin Klein for 15 years based on 1.15% of total worldwide net sales of products bearing any of the *Calvin Klein* brands. Such contingent purchase price payments are recorded as additions to goodwill.

4. RETIREMENT AND BENEFIT PLANS

The Company has noncontributory defined benefit pension plans covering substantially all United States employees meeting certain age and service requirements. For those vested (after five years of service), the plans provide monthly benefits upon retirement based on career compensation and years of credited service.

The Company and its domestic subsidiaries also provide certain postretirement health care and life insurance benefits. Retirees contribute to the cost of this plan, which is unfunded. During 2002, the postretirement plan was amended to eliminate benefits for active participants who, as of January 1, 2003, had not attained age 55 and 10 years of service.

Net benefit cost related to the Company's pension plans was recognized as follows:

| | <u>Pension Plans</u> | | | |
|---------------------------------------|-----------------------------|-----------------|--------------------------------|-----------------|
| | <u>Thirteen Weeks Ended</u> | | <u>Thirty-Nine Weeks Ended</u> | |
| | <u>10/29/06</u> | <u>10/30/05</u> | <u>10/29/06</u> | <u>10/30/05</u> |
| Service cost, including plan expenses | \$1,738 | \$ 1,554 | \$ 5,215 | \$ 4,661 |
| Interest cost | 3,468 | 3,276 | 10,404 | 9,829 |
| Amortization of net loss | 1,332 | 2,114 | 3,998 | 6,341 |
| Expected return on plan assets | (3,881) | (3,289) | (11,632) | (9,866) |
| Amortization of prior service cost | 83 | 392 | 248 | 1,175 |
| Settlement loss | - | - | 2,247 | - |
| Special termination benefits | <u>-</u> | <u>-</u> | <u>723</u> | <u>-</u> |
| Total | <u>\$2,740</u> | <u>\$ 4,047</u> | <u>\$ 11,203</u> | <u>\$12,140</u> |

The settlement loss related to the pension plans for the thirty-nine weeks ended October 29, 2006 resulted from the departure of Mark Weber, the Company's former Chief Executive Officer.

The special termination benefits related to the pension plans for the thirty-nine weeks ended October 29, 2006 resulted from the closure of the Company's manufacturing facility located in Ozark, Alabama.

The Company currently expects to make a voluntary contribution to its qualified pension plans of approximately \$15,000 in the fourth quarter of 2006.

Net benefit cost related to the Company's postretirement plan was recognized as follows:

| | <u>Postretirement Plan</u> | | | |
|------------------------------------|-----------------------------|-----------------|--------------------------------|-----------------|
| | <u>Thirteen Weeks Ended</u> | | <u>Thirty-Nine Weeks Ended</u> | |
| | <u>10/29/06</u> | <u>10/30/05</u> | <u>10/29/06</u> | <u>10/30/05</u> |
| Interest cost | \$ 330 | \$ 425 | \$1,049 | \$1,274 |
| Amortization of net loss | 108 | 100 | 316 | 300 |
| Amortization of prior service cost | (237) | (111) | (613) | (333) |
| Special termination benefits | <u>-</u> | <u>-</u> | <u>242</u> | <u>-</u> |
| Total | <u>\$ 201</u> | <u>\$ 414</u> | <u>\$ 994</u> | <u>\$1,241</u> |

5. SERIES B CONVERTIBLE PREFERRED STOCK

In connection with the Company's acquisition of Calvin Klein, the Company issued \$250,000 of Series B convertible preferred stock. The Series B convertible preferred stock had a conversion price of \$14.00 per share and a dividend rate of 8% per annum, payable quarterly in cash. In certain quarters, the Company elected not to pay a cash dividend and the Series B convertible preferred stock was treated as if an in-kind dividend was paid. As such, the liquidation preference of the originally issued Series B convertible preferred stock increased to \$264,746.

During the second quarter of 2005, the holders of the Series B convertible preferred stock converted an aggregate of \$102,820 of the Series B convertible preferred stock, or 39% of the liquidation value of the preferred stock prior to conversion, into 7,344 shares of the Company's common stock. During the second quarter of 2006, the holders of the Series B convertible preferred stock converted all of the remaining \$161,926 of Series B convertible preferred stock into 11,566 shares of common stock. Please see Note 10, "Net Income per Common Share," for a discussion of the details of the transactions and their impact on the Company's net income per common share calculations.

6. COMPREHENSIVE INCOME

Comprehensive income was as follows:

| | <u>Thirteen Weeks Ended</u> | | <u>Thirty-Nine Weeks Ended</u> | |
|--|-----------------------------|-----------------|--------------------------------|-----------------|
| | <u>10/29/06</u> | <u>10/30/05</u> | <u>10/29/06</u> | <u>10/30/05</u> |
| | | \$50,773 | \$40,289 | \$128,471 |

N e t i n c o m e

Foreign currency translation adjustments,

| | | | | |
|----------------------|----------------------|----------------------|-----------------------|--------------------|
| n e t o f t a x e s | <u> - </u> | <u> 1 </u> | <u> 30 </u> | <u> (101) </u> |
| Comprehensive income | <u>\$50,773</u> | <u>\$40,290</u> | <u>\$128,501</u> | <u>\$88,668</u> |

The income tax effect related to foreign currency translation adjustments was an expense of \$1 for the thirteen weeks ended October 30, 2005. The income tax effect related to foreign currency translation adjustments was an expense of \$19 and a benefit of \$62 for the thirty-nine weeks ended October 29, 2006 and October 30, 2005, respectively.

7. STOCK-BASED COMPENSATION

At the Company's Annual Meeting of Stockholders held on June 13, 2006, the Company's 2006 Stock Incentive Plan (the 2006 Plan) was approved. The 2006 Plan replaced the Company's existing 1997, 2000 and 2003 Stock Option Plans as the source of the Company's equity incentive compensation. The 1997, 2000 and 2003 Stock Option Plans terminated on the date of such approval, other than with respect to outstanding options under those plans, which will continue to be governed by the respective plan under which they were granted. Shares issued as a result of stock option exercises are primarily funded with the issuance of new shares of the Company's common stock.

2006 Stock Incentive Plan

Under the 2006 Plan, the Company may grant the following types of incentive awards: (i) non-qualified stock options (NQs); (ii) incentive stock options (ISOs); (iii) stock appreciation rights; (iv) restricted stock; (v) restricted stock units; (vi) performance shares; and (vii) other stock-based awards. Each award granted under the 2006 Plan is evidenced by an award agreement that specifies, as applicable, the exercise price, the term of the award,

the periods of restriction, the number of shares to which the award pertains, applicable performance period(s) and performance measure(s), and such other terms and conditions as the plan committee determines.

To date, the Company has granted only NQs under the 2006 plan. The per share exercise price of NQs granted under the 2006 Plan cannot be less than the market price of the common stock on the date of grant. The NQs provide for accelerated vesting upon the optionee's retirement (as defined in the 2006 Plan). The maximum duration of an NQ granted under the 2006 Plan is ten years.

1997, 2000 and 2003 Stock Option Plans

Under its 1997, 2000 and 2003 Stock Option Plans, the Company currently has service-based NQs and ISOs outstanding. Options were granted with an exercise price equal to the market price of the common stock on the date of grant. NQs and ISOs granted have a ten-year duration. Options are cumulatively exercisable in either three installments commencing three years after the date of grant or in four installments commencing one year after the date of grant. The options provide for accelerated vesting upon the optionee's retirement (as defined in the 1997, 2000 and 2003 Stock Option Plans).

In the first quarter of 2006, the Company adopted Financial Accounting Standards Board (FASB) Statement No. 123R, Share-Based Payment. FASB Statement No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense in the financial statements based on their fair values. Prior to 2006, the Company accounted for its stock options under the intrinsic value method of Accounting Principles Board (APB) Opinion No. 25. Under APB Opinion No. 25, the Company did not recognize compensation expense because the exercise price of the Company's stock options equaled the market price of the Company's common stock on the date of grant.

The Company adopted FASB Statement No. 123R on a modified prospective basis. Under the modified prospective transition method, FASB Statement No. 123R applies to new awards and awards that were outstanding upon adoption that are subsequently modified, repurchased or cancelled. Stock-based compensation expense recognized during the thirty-nine weeks ended October 29, 2006 includes (i) the expense for all stock options granted prior to, but not yet vested as of January 29, 2006, based on the fair value estimated in accordance with the provisions of FASB Statement No. 123; and (ii) the expense for all stock options granted during the thirty-nine weeks ended October 29, 2006, based on the fair value estimated in accordance with the provisions of FASB Statement No. 123R. Prior periods have not been restated.

Net income for the thirteen weeks ended October 29, 2006 included \$1,686 of pre-tax compensation expense related to stock options (\$1,129 net of tax), which resulted in a \$0.02 decrease in basic and diluted net income per common share. Net income for the thirty-nine weeks ended October 29, 2006 included \$5,707 of pre-tax compensation expense related to stock options (\$3,759 net of tax), which resulted in a \$0.07 decrease in basic and diluted net income per common share. Net income for the thirteen and thirty-nine weeks ended October 30, 2005 did not include

compensation expense related to stock options. The following table illustrates the effect on net income and net income per common share as if the Company had applied the fair value recognition provisions of FASB Statement No. 123 in 2005:

| | Thirteen Weeks Ended <u>10/30/05</u> | Thirty-Nine Weeks Ended <u>10/30/05</u> |
|---|--|---|
| Net income - as reported | \$40,289 | \$88,769 |
| Deduct: Stock-based compensation expense determined under fair value method, net of related tax effects | <u>813</u> | <u>5,048</u> |
| Net income - as adjusted | <u>\$39,476</u> | <u>\$83,721</u> |
| Net income per common share: | | |
| Basic - as reported | <u>\$ 0.88</u> | <u>\$ 1.71</u> |
| Diluted - as reported | <u>\$ 0.73</u> | <u>\$ 1.44</u> |
| Basic - as adjusted | <u>\$ 0.86</u> | <u>\$ 1.57</u> |
| Diluted - as adjusted | <u>\$ 0.71</u> | <u>\$ 1.34</u> |

The Company estimates the fair value of stock options granted at the date of grant using the Black-Scholes model. The estimated fair value of the options, net of estimated forfeitures, is amortized to expense on a straight-line basis over the options' vesting period. At October 29, 2006, there was \$10,521 of unrecognized pre-tax compensation expense related to unvested stock options, which is expected to be recognized over a weighted average period of 2.9 years.

The following summarizes the assumptions used to estimate the fair value of stock options granted during the thirty-nine weeks ended October 29, 2006 and October 30, 2005, respectively:

| | <u>Thirty-Nine Weeks Ended</u> | |
|--|--------------------------------|-----------------|
| | <u>10/29/06</u> | <u>10/30/05</u> |
| Weighted average risk-free interest rate | 4.73% | 4.00% |
| Weighted average expected option life | 6.2 Years | 6.0 Years |
| Weighted average expected volatility | 33.3% | 26.5% |
| Expected annual dividends per share | \$0.15 | \$0.15 |
| Weighted average estimated fair value per share of options granted | \$15.41 | \$8.74 |

The risk-free interest rate is based on United States Treasury yields in effect at the date of grant for periods corresponding to the expected option life. The expected option life represents the weighted average period of time that options granted are expected to be outstanding, based on vesting schedules and the contractual term of the options. Expected volatility is based on the historical volatility of the Company's common stock over a period of time corresponding to the expected option life. Expected dividends are based on the Company's common stock dividend policy at the date of grant.

The Company receives a tax deduction for certain stock options when they are exercised. Prior to the adoption of FASB Statement No. 123R, the Company reported tax benefits resulting from the exercise of stock options as operating cash flows in its Condensed Consolidated Statements of Cash Flows. In accordance with FASB Statement No. 123R, the Company now reports excess tax benefits, if any, as financing cash flows. The actual income tax benefit realized from stock option exercises for the thirty-nine weeks ended October 29, 2006 was \$6,265, of which \$3,119 was reported as excess tax benefits from stock option exercises in financing cash flows, with no comparable amount in 2005. Excess tax benefits arise when the actual tax benefit resulting from a stock option exercise exceeds the tax benefit associated with the grant date fair value of the related stock option.

Stock option activity for the thirty-nine weeks ended October 29, 2006 was as follows:

| | <u>Options</u> | <u>Weighted Average Price Per Option</u> |
|---|----------------|--|
| O u t s t a n d i n g a t J a n u a r y 2 9 , 2 0 0 6 | 4,384 | \$21.31 |
| G r a n t e d | 486 | 38.38 |
| E x e r c i s e d | 698 | 14.72 |
| C a n c e l l e d | <u>88</u> | <u>23.75</u> |
| Outstanding at October 29, 2006 | <u>4,084</u> | <u>\$24.41</u> |
| Exercisable at October 29, 2006 | <u>1,879</u> | <u>\$18.32</u> |

At October 29, 2006, the aggregate intrinsic value of options issued and outstanding was \$86,867, and the aggregate intrinsic value of options exercisable was \$51,423. The aggregate intrinsic value of options exercised during the thirty-nine weeks ended October 29, 2006 was \$15,940.

The aggregate grant date fair value of options that vested during the thirty-nine weeks ended October 29, 2006 was \$8,140.

The weighted average remaining contractual life of options outstanding and options exercisable at October 29, 2006 was 7.5 and 6.1 years, respectively.

Total stock options available for grant at October 29, 2006 amounted to 3,864 shares.

8. ACTIVITY EXIT COSTS, ASSET IMPAIRMENTS AND OTHER CHARGES

Activity Exit Costs

On March 6, 2006, the Company committed to a plan to close its manufacturing facility located in Ozark, Alabama. This decision was based on the competitive environment in the apparel industry in which the Company operates and the expiration of import quotas in 2005. The actions related to the exit plan were completed in the second quarter of 2006. Costs associated with closing the facility were as follows:

| | Total Expected to be <u>Incurred</u> | Incurred During Thirty-Nine Weeks <u>Ended 10/29/06</u> | Liability <u>at 10/29/06</u> |
|------------------------------------|---|--|---------------------------------|
| Severance and termination benefits | \$ 8,767 | \$ 8,767 | \$3,658 |
| Long-lived asset impairments | 988 | 988 | - |
| Facility closing and other costs | <u>1,539</u> | <u>1,539</u> | <u>-</u> |
| Total | <u>\$11,294</u> | <u>\$11,294</u> | <u>\$3,658</u> |

The costs associated with closing the facility relate to, and are included in selling, general and administrative expenses of the Wholesale Dress Shirt segment.

Asset Impairments

In 2006, during the Company's annual budget process for determining new outlet retail store locations, the level of profitability in certain of the Company's existing outlet retail stores, principally in the Midwestern section of the United States, was an impairment indicator which caused the Company to evaluate whether the net book value of the long-lived assets in such stores was recoverable. Based on these evaluations, the Company determined that the long-lived assets in certain of these stores were not recoverable and recorded an impairment of \$2,314, of which \$396

was recorded in the third quarter of 2006. This determination was made by comparing each store's expected undiscounted future cash flows to the carrying amount of the long-lived assets. Since the long-lived assets in certain stores were deemed not recoverable, the net book value of the long-lived assets in excess of the fair value was written off. Fair value was estimated based on the net present value of the future cash flows expected from these stores. This amount relates to, and is included in selling, general and administrative expenses of the Retail Apparel and Related Products segment.

During 2005, Federated Department Stores, Inc. (Federated) acquired The May Department Stores Company. In connection with the acquisition, Federated has closed certain of its locations. Since the Company had identifiable long-lived assets consisting of shops within stores (fixtures located in third party customer locations) in certain of the locations being closed, this was an impairment indicator which caused the Company to evaluate whether the net book value of these long-lived assets was recoverable. In the first nine months of 2006, the Company determined that the long-lived assets in these locations were not recoverable and recorded an impairment of \$116. Since the long-lived assets related to locations to be closed, there were deemed to be no future cash flows associated with these locations, and therefore a fair value of zero was determined to apply to the long-lived assets in these locations. As such, the impairment recorded was equal to the net book value of the long-lived assets in these locations. This amount relates to, and is included in selling, general and administrative expenses of the Wholesale Sportswear and Related Products segment.

Other Charges

On February 27, 2006, the Company announced that its Board of Directors had named Emanuel Chirico as Chief Executive Officer of the Company. Mr. Chirico, who had been the Company's President and Chief Operating Officer, succeeded Mark Weber, who left the Company effective February 27, 2006 by agreement with the Company's Board of Directors. Severance and other separation costs of \$10,535 were recorded in the first quarter of 2006 in connection with the departure of Mr. Weber. These costs are included in Corporate selling, general and administrative expenses.

9. SALE OF INVESTMENT

On January 31, 2006, Warnaco, Inc. (Warnaco) acquired 100% of the shares of the companies that operate the licenses and related wholesale and retail businesses of *Calvin Klein* jeans and accessories in Europe and Asia and the *ck Calvin Klein* bridge line of sportswear and accessories in Europe. The Company's Calvin Klein, Inc. subsidiary is the licensor of the businesses sold and had minority interests in certain of the entities sold. The Company accounted for the investment in these entities under the cost method and, as such, the investment had a carrying amount of \$768 at the time of the sale. The Company received \$32,811 in cash proceeds from the sale of these entities, net of amounts held in escrow and certain associated fees. The cash proceeds are subject to adjustments, including adjustments based upon the determination of actual working capital as of the closing date. The Company's share of the cash proceeds being held in escrow totaled \$5,000 as of October 29, 2006, and represents security for indemnification of certain potential losses incurred by Warnaco, as well as other adjustments to the purchase price. The sale resulted in a pre-tax gain of \$32,043, which is net of related fees, amounts held in escrow and the carrying value of the investment. The Company will be entitled to receive distributions of a portion of any amounts remaining in escrow in installments during 2007 and 2008. The Company will record the release of any escrow amounts as additional gains if and when such amounts are released to the Company.

10. NET INCOME PER COMMON SHARE

The Company computed its basic and diluted net income per common share as follows:

| | <u>Thirteen Weeks Ended</u> | | <u>Thirty-Nine Weeks Ended</u> | |
|--|-----------------------------|-----------------|--------------------------------|-----------------|
| | <u>10/29/06</u> | <u>10/30/05</u> | <u>10/29/06</u> | <u>10/30/05</u> |
| N e t i n c o m e | \$50,773 | \$40,289 | \$128,471 | \$88,769 |
| Less: | | | | |
| Preferred stock dividends on convertible stock | - | 3,229 | - | 9,688 |

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| | | | | |
|--|-----------------|-----------------|------------------|-----------------|
| Preferred stock dividends on converted stock | - | - | 3,230 | 2,051 |
| Inducement payments and offering costs | <u>-</u> | <u>-</u> | <u>10,948</u> | <u>14,205</u> |
| Net income available to common stockholders for | | | | |
| basic net income per common share | 50,773 | 37,060 | 114,293 | 62,825 |
| Add back preferred stock dividends on convertible stock | <u>-</u> | <u>3,229</u> | <u>-</u> | <u>9,688</u> |
| Net income available to common stockholders for | | | | |
| diluted net income per common share | <u>\$50,773</u> | <u>\$40,289</u> | <u>\$114,293</u> | <u>\$72,513</u> |
| Weighted average common shares outstanding for | | | | |
| basic net income per common share | 55,430 | 42,063 | 50,921 | 36,845 |
| Impact of dilutive stock options | 1,284 | 1,741 | 1,204 | 1,905 |
| Impact of dilutive warrant | 99 | 36 | 83 | 23 |
| Impact of assumed convertible preferred stock conversion | <u>-</u> | <u>11,566</u> | <u>-</u> | <u>11,566</u> |
| Total shares for diluted net income per common share | <u>56,813</u> | <u>55,406</u> | <u>52,208</u> | <u>50,339</u> |
| Basic net income per common share | <u>\$ 0.92</u> | <u>\$ 0.88</u> | <u>\$ 2.24</u> | <u>\$ 1.71</u> |
| Diluted net income per common share | <u>\$ 0.89</u> | <u>\$ 0.73</u> | <u>\$ 2.19</u> | <u>\$ 1.44</u> |

During the second quarter of 2005, the holders of the Company's Series B convertible preferred stock completed a voluntary conversion of a portion of such stock into 7,344 shares of the Company's common stock. Such shares of common stock were subsequently sold in a registered offering by the holders. In connection with these transactions, the Company made an inducement payment to the preferred stockholders of \$1.75 for each share of common stock sold, or an aggregate of \$12,853. The inducement payment was based on the net present value of the dividends that the Company would have been obligated to pay the preferred stockholders through the earliest date on which it was estimated that the Company would have had the right to convert the Series B convertible preferred stock, net of the net present value of the dividends payable over the same period on the shares of common stock into which the Series B convertible preferred stock was convertible. In addition, the Company incurred certain costs, totaling \$1,352, specifically related to the registered common stock offering.

During the second quarter of 2006, the holders of the Series B convertible preferred stock completed a voluntary conversion of all of the remaining outstanding shares of Series B convertible preferred stock into 11,566 shares of common stock. The holders sold 10,057 of such shares in a registered common stock offering. In connection with the conversion, the Company made an inducement payment to the preferred stockholders of \$0.88 for each share of common stock received upon conversion, or an aggregate of \$10,178. The inducement payment was based on the net present value of the dividends that the Company would have been obligated to pay the preferred stockholders through the earliest date on which it was estimated that the Company would have had the right to convert the Series B convertible preferred stock, net of the net present value of the dividends payable over the same period on the shares of common stock into which the Series B convertible preferred stock was convertible. In addition, the Company incurred certain costs, totaling \$770, specifically related to the registered common stock offering.

As set forth in Emerging Issues Task Force (EITF) Topic D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock," when convertible preferred stock is converted pursuant to an inducement offer, the excess of the fair value of consideration transferred in the transaction to the holders of the convertible preferred stock over the fair value of the securities issuable pursuant to the original conversion terms should be subtracted from net income to arrive at net income available to common stockholders in the calculation of net income per common share. As such, the inducement payments and offering costs paid by the Company in connection with the conversions and subsequent registered common stock offerings resulted in reductions of net income available to common stockholders for the thirty-nine weeks ended October 29, 2006 and October 30, 2005.

Potentially dilutive securities excluded from the calculation of diluted net income per common share were as follows:

| | <u>Thirteen Weeks Ended</u> | | <u>Thirty-Nine Weeks Ended</u> | |
|---|-----------------------------|-----------------|--------------------------------|-----------------|
| | <u>10/29/06</u> | <u>10/30/05</u> | <u>10/29/06</u> | <u>10/30/05</u> |
| Antidilutive stock options and warrants | <u>11</u> | <u>83</u> | <u>174</u> | <u>208</u> |

In addition, conversion of the Series B convertible preferred stock that was converted into 4,321 weighted average common shares outstanding for the thirty-nine weeks ended October 29, 2006 was not assumed because the resulting

impact on the calculation of diluted net income per common share would have been antidilutive.

As set forth in EITF Topic D-53, Computation of Earnings per Share for a Period That Includes a Redemption or an Induced Conversion of a Portion of a Class of Preferred Stock, when a company effects an induced conversion of only a portion of a class of the company's then-outstanding preferred stock, any excess consideration should be attributed to the converted shares, and the converted shares should be considered separately from the shares that were not converted for purposes of applying the if-converted method from the beginning of the period. As such, for purposes of the Company's computation of diluted net income per common share for the thirty-nine weeks ended October 30, 2005, the portion of the Series B convertible preferred stock that was converted was considered separately from the portion of the Series B convertible preferred stock that was not converted. The inducement payment and offering costs paid by the Company in connection with the conversion and subsequent registered common stock offering were attributed to the portion of the Series B convertible preferred stock that was converted. As a result, conversion of the portion of the Series B convertible preferred stock that was converted into 4,463 weighted average common shares outstanding for the thirty-nine weeks ended October 30, 2005 was not assumed because the resulting impact on the calculation of diluted net income per common share would have been antidilutive.

11. NONCASH INVESTING AND FINANCING TRANSACTIONS

Omitted from the Financing Activities section of the Condensed Consolidated Statement of Cash Flows for the thirty-nine weeks ended October 30, 2005 was a decrease in the Company's Series B convertible preferred stock of \$102,820, an increase in common stock of \$7,302, an increase in additional capital of \$94,870 and a decrease in treasury stock of \$648 associated with the conversion of a portion of the Series B convertible preferred stock. Please see Note 5, Series B Convertible Preferred Stock.

Omitted from the Financing Activities section of the Condensed Consolidated Statement of Cash Flows for the thirty-nine weeks ended October 29, 2006 was a decrease in Series B convertible preferred stock of \$161,926, an increase in common stock of \$11,566 and an increase in additional capital of \$150,360 associated with the conversion of all of the remaining outstanding shares of the Series B convertible preferred stock. Please see Note 5, Series B Convertible Preferred Stock.

12. SEGMENT DATA

The Company manages its operations through its operating divisions, which are aggregated into five reportable segments: (i) Wholesale Dress Shirt; (ii) Wholesale Sportswear and Related Products; (iii) Retail Apparel and Related Products; (iv) Retail Footwear and Related Products; and (v) Calvin Klein Licensing.

Wholesale Dress Shirt Segment - This segment represents the results of the Company's wholesale dress shirt division. This division derives revenues primarily from marketing dress shirts under the brand names *Van Heusen, IZOD, Geoffrey Beene, Arrow, Kenneth Cole New York, Kenneth Cole Reaction, unlisted, A Kenneth Cole Production, Calvin Klein Collection, ck Calvin Klein, Calvin Klein, BCBG Max Azria, BCBG Attitude, MICHAEL Michael Kors, Chaps, Sean John, Donald J. Trump Signature Collection* and, beginning in the second quarter of 2006, *JOE Joseph Abboud* to department, mid-tier department and specialty stores.

Wholesale Sportswear and Related Products Segment - The Company aggregates its wholesale sportswear divisions into the Wholesale Sportswear and Related Products segment. This segment derives revenues primarily from marketing sportswear under the brand names *Van Heusen, IZOD, Geoffrey Beene, Arrow, Calvin Klein* and, beginning in 2006, *Donald J. Trump Signature Collection* to department, mid-tier department and specialty stores.

Retail Apparel and Related Products Segment - The Company aggregates its Van Heusen, Izod, Geoffrey Beene and Calvin Klein outlet retail divisions into the Retail Apparel and Related Products segment. This segment derives

revenues principally from operating retail stores in the outlet channel of distribution which sell apparel and accessories under the brand names *Van Heusen*, *IZOD*, *Geoffrey Beene* and *Calvin Klein*. In addition, the Company aggregates the results of its Calvin Klein Collection Retail division into the Retail Apparel and Related Products segment. This division sells *Calvin Klein Collection* branded high-end collection apparel and accessories through the Company's own full price retail store located in New York City. In 2005, this division also included the sales of the Company's *Calvin Klein Collection* stores located in Dallas and Paris, which the Company closed at the end of 2005.

Retail Footwear and Related Products Segment - This segment represents the results of the Company's Bass Retail division. This division derives revenues principally from operating retail stores, primarily in the outlet channel of distribution, which sell footwear, apparel and accessories under the *Bass* brand name.

Calvin Klein Licensing Segment - The Company aggregates the results of its Calvin Klein licensing and advertising divisions into the Calvin Klein Licensing segment. This segment derives revenues from licensing and similar arrangements worldwide relating to the use by third parties of the *Calvin Klein Collection*, *ck Calvin Klein* and *Calvin Klein* brands for a broad array of products and retail services.

Prior to the end of its fiscal 2005 year, the Company aggregated its divisions into two segments: (i) Calvin Klein Licensing; and (ii) Apparel and Related Products. In the first quarter of 2006, the United States Securities and Exchange Commission (SEC) requested certain information from the Company in connection with an ordinary course review of the Company's Annual Report on Form 10-K for fiscal 2004, including how the Company aggregated segment data. As a result of communications with the SEC, the Company re-evaluated the way it

aggregated its operating divisions into its reportable segments under FASB Statement No. 131, Disclosures about Segments of an Enterprise and Related Information. The Apparel and Related Products segment was disaggregated into the Wholesale Dress Shirt, Wholesale Sportswear and Related Products, Retail Apparel and Related Products, and Retail Footwear and Related Products segments described above. Prior year segment data has been reclassified for this change.

The following table presents summarized information by segment:

| | <u>Thirteen Weeks Ended</u> | | <u>Thirty-Nine Weeks Ended</u> | |
|---|-----------------------------|-----------------|--------------------------------|-----------------|
| | <u>10/29/06</u> | <u>10/30/05</u> | <u>10/29/06</u> | <u>10/30/05</u> |
| <u>Revenues - Wholesale Dress Shirt</u> | | | | |
| Net sales | \$ 97,662 | \$111,084 | \$ 277,477 | \$ 318,943 |
| Royalty revenues | 1,841 | 1,714 | 4,983 | 4,719 |
| Advertising and other revenues | <u>613</u> | <u>318</u> | <u>1,423</u> | <u>869</u> |
| Total | 100,116 | 113,116 | 283,883 | 324,531 |
| <u>Revenues - Wholesale Sportswear and Related Products</u> | | | | |
| Net sales | 162,281 | 153,084 | 426,934 | 387,097 |
| Royalty revenues | 3,046 | 2,963 | 8,565 | 7,993 |
| Advertising and other revenues | <u>1,026</u> | <u>1,162</u> | <u>3,554</u> | <u>3,017</u> |
| Total | 166,353 | 157,209 | 439,053 | 398,107 |
| <u>Revenues - Retail Apparel and Related Products</u> | | | | |
| Net sales | 163,305 | 140,508 | 452,105 | 399,909 |
| Royalty revenues | <u>2,050</u> | <u>2,153</u> | <u>5,789</u> | <u>5,564</u> |
| Total | 165,355 | 142,661 | 457,894 | 405,473 |
| <u>Revenues - Retail Footwear and Related Products</u> | | | | |
| Net sales | 76,987 | 67,102 | 205,027 | 186,502 |
| Royalty revenues | <u>161</u> | <u>124</u> | <u>486</u> | <u>374</u> |
| Total | 77,148 | 67,226 | 205,513 | 186,876 |

Revenues - Calvin Klein Licensing

| | | | | |
|--------------------------------|---------------|---------------|---------------|---------------|
| Royalty revenues | 44,939 | 40,605 | 110,561 | 98,409 |
| Advertising and other revenues | <u>14,350</u> | <u>12,364</u> | <u>36,723</u> | <u>35,363</u> |
| Total | 59,289 | 52,969 | 147,284 | 133,772 |

Total Revenues

| | | | | |
|--------------------------------|------------------|------------------|--------------------|--------------------|
| Net sales | 500,235 | 471,778 | 1,361,543 | 1,292,451 |
| Royalty revenues | 52,037 | 47,559 | 130,384 | 117,059 |
| Advertising and other revenues | <u>15,989</u> | <u>13,844</u> | <u>41,700</u> | <u>39,249</u> |
| Total | <u>\$568,261</u> | <u>\$533,181</u> | <u>\$1,533,627</u> | <u>\$1,448,759</u> |

| | | | | |
|--|------------------|------------------|--------------------------|-------------------|
| Operating income - Wholesale Dress Shirt | \$ 16,532 | \$ 18,711 | \$ 31,648 ⁽¹⁾ | \$ 50,938 |
| Operating income - Wholesale Sportswear and Related Products | 27,071 | 26,545 | 77,658 | 65,115 |
| Operating income - Retail Apparel and Related Products | 17,556 | 5,632 | 42,457 | 16,661 |
| Operating income - Retail Footwear and Related Products | 8,794 | 9,100 | 13,217 | 6,103 |
| Operating income - Calvin Klein Licensing | 27,690 | 21,129 | 100,735 ⁽²⁾ | 54,131 |
| Corporate expenses ⁽³⁾ | <u>13,000</u> | <u>9,509</u> | <u>47,568</u> | <u>28,589</u> |
| Income before interest and taxes | <u>\$ 84,643</u> | <u>\$ 71,608</u> | <u>\$ 218,147</u> | <u>\$ 164,359</u> |

(1) Operating income for the Wholesale Dress Shirt segment for the thirty-nine weeks ended October 29, 2006 includes \$11,294 of costs associated with closing the Company's manufacturing facility in Ozark, Alabama.

(2) Operating income for the Calvin Klein Licensing segment for the thirty-nine weeks ended October 29, 2006 includes a gain of \$32,043 associated with the sale by a subsidiary of the Company of minority interests in certain entities that operate various *Calvin Klein* jeans and sportswear businesses in Europe and Asia.

(3) Corporate expenses represent overhead operating expenses that the Company does not allocate to its segments and include expenses for senior corporate management, corporate finance and information technology related to corporate infrastructure. Additionally, beginning in 2006, the Company includes all stock-based compensation expenses in Corporate expenses. Corporate expenses for the thirty-nine weeks ended October 29, 2006 include \$10,535 of severance and related costs resulting from the departure of Mark Weber, the Company's former Chief Executive Officer.

13. OTHER COMMENTS

The Company has guaranteed the payment of certain purchases made by one of the Company's suppliers from a raw material vendor. The maximum amount guaranteed is \$500. The guarantee expires on January 31, 2007.

The Company has guaranteed the payment of rent and related costs to the Company's former landlord by the tenant currently occupying space previously leased by the Company. The maximum amount guaranteed as of October 29, 2006 is approximately \$4,500, which is subject to exchange rate fluctuation. The Company has the right to seek recourse of approximately \$2,800 as of October 29, 2006, which is subject to exchange rate fluctuation. The guarantee expires on May 19, 2016.

The Company has certain investments in commercial paper with maturities of two months or less from the time of purchase. These investments are reported as cash and cash equivalents. At October 29, 2006, the fair value of these investments approximated the carrying amount of \$71,867.

14. NEW ACCOUNTING STANDARDS

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* - an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 requires that the financial statement effects of a tax position be recognized when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. A tax position that meets the more likely than not recognition threshold shall initially and subsequently

be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. The Company must adopt FIN 48 as of the beginning of its fiscal year 2007. The Company is currently evaluating the impact, if any, the adoption of FIN 48 is expected to have on its consolidated results of operations and financial position.

In September 2006, the FASB issued FASB Statement No. 157, Fair Value Measurements. This statement clarifies the definition of fair value, establishes a framework for measuring fair value and expands disclosures about the use of fair value measurements. The Company must adopt FASB Statement No. 157 as of the beginning of its fiscal year 2007. The Company currently does not expect the adoption of FASB Statement No. 157 to have any impact on its consolidated results of operations and financial position.

In September 2006, the FASB issued FASB Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R). This statement requires a company to recognize the overfunded or underfunded status of a defined benefit pension or other postretirement plan as an asset or a liability in its statement of financial position and to recognize gains and losses that have not yet been recognized through net periodic benefit cost in comprehensive income, net of income tax effects. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective for the Company as of the end of the current fiscal year. The Company does not expect the adoption of FASB Statement No. 158 to have a material impact on its consolidated results of operations or financial position.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 was issued to address diversity in practice in quantifying financial statement misstatements. For purposes of assessing materiality, SAB 108 requires quantification of misstatements, including both the carryover and reversing effects of prior year misstatements on the current year financial statements and related financial disclosures. Companies will be required to adjust their financial statements if material misstatements exist. The Company must adopt SAB 108 as of the end of the current fiscal year. The Company does not expect the adoption of SAB 108 to have a material impact on its consolidated results of operations or financial position.

15. PENDING ACQUISITION

On October 11, 2006, the Company entered into an agreement with Superba, Inc. (Superba), a privately-held manufacturer and distributor of neckwear in the United States and Canada, and A. Mervyn Mandelbaum, the Chief Executive Officer and controlling shareholder of Superba, under which the Company expects to acquire substantially all of Superba's assets. The purchase price for the assets is \$110,000, subject to adjustment for working capital, plus an earn-out over a three-year period based on the earnings of the acquired business for each of the first three years after the closing, with a maximum value of \$70,000. The closing is expected to be effective on January 1, 2007.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

References to the brand names *Calvin Klein Collection*, *ck Calvin Klein*, *Calvin Klein*, *Van Heusen*, *IZOD*, *Arrow*, *Bass*, *Eagle*, *Geoffrey Beene*, *BCBG Max Azria*, *BCBG Attitude*, *Chaps*, *Sean John*, *Donald J. Trump Signature Collection*, *Kenneth Cole New York*, *Kenneth Cole Reaction*, *unlisted*, *A Kenneth Cole Production*, *JOE Joseph Abboud* and *MICHAEL Michael Kors*, and to other brand names in this report are to registered trademarks owned by us or licensed to us by third parties and are identified by italicizing the brand name.

OVERVIEW

The following discussion and analysis is intended to help you understand us, our operations and our financial performance. It should be read in conjunction with our condensed consolidated financial statements and the accompanying notes, which are included elsewhere in this report.

We are one of the largest apparel companies in the world, with a heritage dating back over 125 years. Our brand portfolio consists of nationally recognized brand names, including *Calvin Klein*, *Van Heusen*, *IZOD*, *Arrow*, *Bass* and *Eagle*, which are owned, and *Geoffrey Beene*, *Kenneth Cole New York*, *Kenneth Cole Reaction*, *BCBG Max Azria*, *BCBG Attitude*, *Sean John*, *Chaps*, *Donald J. Trump Signature Collection* and *MICHAEL Michael Kors*, which are licensed. We launched new licensed lines of dress shirts under the *unlisted*, *A Kenneth Cole Production* brand in the first quarter of 2006 and the *JOE Joseph Abboud* brand in the second quarter of 2006.

Our historical strategy has been to manage and market a portfolio of nationally recognized brands across multiple product categories, through multiple channels of distribution and at multiple price points. This strategy was enhanced by our acquisition of Calvin Klein, Inc. and certain affiliated companies (*Calvin Klein*) in February 2003, which provided us with one of the most famous designer names in the world and an additional platform for growth in revenues and profitability. Through that transaction, we were able to diversify our business model by providing growth opportunities from strong and highly profitable licensing streams which do not require capital investments. Equally important, we also have broadened the reach of the *Calvin Klein* brands through growth of existing businesses and entry into new businesses, both directly by us and through licensees. This additional diversification, in terms of product, positioning, business model and opportunity has not only enhanced our growth prospects, but has also further moderated our risk to a downturn in any one of our businesses.

On October 11, 2006, we entered into an agreement with Superba, Inc. (*Superba*), a privately-held manufacturer and distributor of neckwear in the United States and Canada, under which we expect to acquire substantially all of Superba's assets. This acquisition is consistent with our strategy of adding brands or product categories that complement our existing businesses, in this case, dress shirts. The purchase price for the assets is \$110 million, subject to adjustment for working capital, plus an earn-out over a three-year period based on the earnings of the acquired business for each of the first three years after the closing, with a maximum value of \$70 million. The

acquisition is expected to close effective on January 1, 2007. Our forward-looking results of operations discussed below do not include the impact of this acquisition, which would not be expected to have a material effect on 2006 revenues and earnings.

OPERATIONS OVERVIEW

We generate net sales from (i) the wholesale distribution of men's dress shirts and sportswear, principally under the brand names *Van Heusen*, *Arrow*, *Geoffrey Beene*, *Calvin Klein*, *IZOD*, *BCBG Max Azria*, *BCBG Attitude*, *Chaps*, *Sean John*, *Donald J. Trump Signature Collection*, *Kenneth Cole New York*, *Kenneth Cole Reaction*, *MICHAEL Michael Kors*, *unlisted*, *A Kenneth Cole Production* (beginning in the first quarter of 2006) and *JOE Joseph Abboud* (beginning in the second quarter of 2006), as well as various private labels; and (ii) the sale, through approximately 700 company-operated retail stores, of apparel, footwear and accessories under the brand names *Van Heusen*, *IZOD*, *Geoffrey Beene*, *Bass* and *Calvin Klein*. Our stores principally operate in an outlet format. We also operate a *Calvin Klein Collection* store located in New York City, in which we principally sell men's and women's high-end collection apparel and accessories, soft home furnishings and tableware. Net sales in 2005 include our *Calvin Klein Collection* stores in Dallas and Paris, which we closed at the end of 2005. We will be discontinuing sales of our

licensed line of *MICHAEL Michael Kors* dress shirts during the third quarter of 2007 in connection with the licensor's discontinuance of its other licensed menswear offerings under the brand.

We generate royalty, advertising and other revenues from fees for licensing the use of our trademarks. Calvin Klein royalty, advertising and other revenues comprised 86% of total royalty, advertising and other revenues in the first nine months of 2006. Calvin Klein royalty, advertising and other revenues are derived principally under licenses and other arrangements for jeans, underwear, fragrances, eyewear, watches and home furnishings.

In the first nine months of 2006, net sales were 89% and royalty, advertising and other revenues were 11% of our total revenues.

Gross profit on total revenues is total revenues less cost of goods sold. We include as cost of goods sold, costs associated with the production and procurement of product, including inbound freight costs, purchasing and receiving costs, inspection costs, internal transfer costs and other product procurement related charges. Since there is no cost of goods sold associated with royalty, advertising and other revenues, 100% of such revenues are included in gross profit. Due to the above factors, our gross profit may not be comparable to that of other entities.

Selling, general and administrative expenses include all other expenses, excluding interest and income taxes. Salaries and related fringe benefits are the largest component of selling, general and administrative expenses, comprising 47% of such expenses in the first nine months of 2006. Rent and occupancy for offices, warehouses and retail stores is the next largest expense, comprising 20% of selling, general and administrative expenses in the first nine months of 2006.

RESULTS OF OPERATIONS

Thirteen Weeks Ended October 29, 2006 Compared With Thirteen Weeks Ended October 30, 2005

Net Sales

Net sales in the third quarter of 2006 increased 6.0% to \$500.2 million from \$471.8 million in the prior year. This increase included the following: (i) \$32.7 million of net sales attributable to growth in our retail segments, driven by an 11% increase in comparative store sales and the opening of *Calvin Klein* outlet retail stores in premium outlet malls; and (ii) \$9.2 million of net sales attributable to growth in our Wholesale Sportswear and Related Products segment, driven by increases across all of our wholesale sportswear divisions. These increases were offset, in part, by a \$13.4 million anticipated sales decrease in our Wholesale Dress Shirt segment resulting from the residual impact of door closings associated with the 2005 acquisition by Federated Department Stores, Inc. (Federated) of The May

Department Stores Company (May).

Royalty, Advertising and Other Revenues

Royalty, advertising and other revenues in the third quarter of 2006 increased 10.8% to \$68.0 million from \$61.4 million in the prior year. Of the \$6.6 million increase, \$6.3 million was attributable to our Calvin Klein Licensing segment due to new licensees and growth exhibited by existing licensees, particularly from fragrances.

Gross Profit on Total Revenues

Gross profit on total revenues in the third quarter of 2006 was \$280.4 million, or 49.3% of total revenues, compared with \$249.2 million, or 46.7% of total revenues in the prior year. The 260 basis point improvement was due principally to strong product sell-throughs, which yielded more full-price selling. Also contributing to the increase was a change in revenue mix, as (i) net sales attributable to our outlet retail businesses, which have higher gross margins than our wholesale businesses, increased as a percentage of our total net sales; and (ii) royalty, advertising and other revenues increased as a percentage of total revenues. Royalty, advertising and other revenues do not carry a cost of sales, and as such, the gross profit percentage of such revenues is 100%.

Selling, General and Administrative (SG&A) Expenses

SG&A expenses in the third quarter of 2006 were \$195.7 million, or 34.4% of total revenues, and \$177.6 million, or 33.3% of total revenues, in the prior year. The \$18.1 million increase in SG&A expenses in the third quarter of 2006 included \$1.7 million of noncash stock option expense resulting from the requirement to expense stock options beginning in 2006. Please see Note 7, Stock-Based Compensation, in the Notes to Condensed Consolidated Financial Statements for a further discussion of our stock-based compensation expense and related information. Also contributing to the increase were (i) increased expenses in our Retail Apparel and Related Products, Retail Footwear and Related Products, and Wholesale Sportswear and Related Products segments to support the sales growth previously mentioned, including from operating additional *Calvin Klein* outlet retail stores; (ii) increased advertising expenditures; and (iii) overall higher administrative expenses, including medical expenses due to increased claims in the current year.

Interest Expense, Net

The majority of our interest expense relates to our fixed rate long-term debt. As a result, variances in our net interest expense tend to be driven by changes in interest income and, to a lesser extent, costs related to our revolving credit facility.

Net interest expense in the third quarter of 2006 was \$3.9 million compared with \$7.2 million in the prior year. The net interest expense decrease was due principally to an increase in interest income from our higher cash position and an increase in investment rates of return over the prior year.

Income Taxes

Income taxes for the current year are estimated at a rate of 37.1%, compared with last year's full year rate of 37.3%.

Thirty-Nine Weeks Ended October 29, 2006 Compared With Thirty-Nine Weeks Ended October 30, 2005

Net Sales

Net sales in the first nine months of 2006 increased 5.3% to \$1,361.5 million from \$1,292.5 million in the prior year. This increase included the following: (i) \$70.7 million of net sales attributable to growth in our retail segments, driven

by an 8% increase in comparative store sales and the opening of *Calvin Klein* outlet retail stores in premium outlet malls; and (ii) \$39.8 million of net sales attributable to growth in our Wholesale Sportswear and Related Products segment, particularly from our *Arrow* sportswear line and our *Calvin Klein* men's better sportswear line. These increases were offset, in part, by a \$41.5 million anticipated sales decrease in our Wholesale Dress Shirt segment, resulting principally from door closings associated with the 2005 acquisition by Federated of May, as the combined company has closed certain of its stores.

Net sales for the full year 2006 are expected to increase approximately 8%, due principally to the items noted above and the effect in the fourth quarter of the following: (i) growth in our Wholesale Sportswear and Related Products segment, particularly from our *IZOD* sportswear line and our *Calvin Klein* men's better sportswear line; (ii) increases in comparative store sales for our retail divisions and additional *Calvin Klein* outlet retail stores in premium outlet malls; and (iii) growth in our Wholesale Dress Shirt segment, as the effect of the Federated/May door closings began to impact us in the fourth quarter of last year.

Royalty, Advertising and Other Revenues

Royalty, advertising and other revenues in the first nine months of 2006 increased 10.1% to \$172.1 million from \$156.3 million in the prior year. Of the \$15.8 million increase, \$13.5 million was attributable to our Calvin Klein Licensing segment due to new licensees and growth exhibited by existing licensees, particularly from fragrances.

We currently expect that royalty, advertising and other revenues will increase 10% to 11% for the full year 2006, both as a result of growth in the businesses of existing licensees, as well as royalties generated from new license agreements.

Gross Profit on Total Revenues

Gross profit on total revenues in the first nine months of 2006 was \$750.3 million, or 48.9% of total revenues, compared with \$668.8 million, or 46.2% of total revenues in the prior year. The 270 basis point improvement was due principally to strong product sell-throughs, which yielded more full-price selling. Also contributing to the increase was a change in revenue mix, as (i) net sales attributable to our outlet retail businesses, which have higher gross margins than our wholesale businesses, increased as a percentage of our total net sales; and (ii) royalty, advertising and other revenues increased as a percentage of total revenues. Royalty, advertising and other revenues do not carry a cost of sales, and as such, the gross profit percentage of such revenues is 100%.

We currently expect that the increase in the gross profit on total revenues percentage for the full year 2006 will not be as pronounced as the increase experienced in the first nine months of 2006, due in part to higher forecasted growth in our wholesale businesses during the fourth quarter than in our outlet retail businesses. As a result, we anticipate that the gross profit on total revenues percentage will increase by approximately 200 basis points in 2006 as compared with 2005.

Selling, General and Administrative (SG&A) Expenses

SG&A expenses in the first nine months of 2006 were \$564.1 million, or 36.8% of total revenues, and \$504.4 million, or 34.8% of total revenues, in the prior year. The \$59.7 million increase in SG&A expenses in the first nine months of 2006 included: (i) \$11.3 million in costs associated with the closing of our manufacturing facility in Ozark, Alabama in May 2006; (ii) \$10.5 million in severance and other separation costs associated with the February 2006 departure of Mark Weber, our former Chief Executive Officer; and (iii) \$5.7 million of noncash stock option expense resulting from the requirement to expense stock options beginning in 2006. Please see Note 7, Stock-Based Compensation, in the Notes to Condensed Consolidated Financial Statements for a further discussion of our stock-based compensation expense and related information. Also contributing to the increase were (i) increased expenses in our Retail Apparel and Related Products, Retail Footwear and Related Products, and Wholesale Sportswear and Related Products segments to support the sales growth previously mentioned, including from operating additional *Calvin Klein* outlet retail stores; (ii) recording a long-lived asset impairment related to certain underperforming outlet retail stores; (iii) increased advertising expenditures; and (iv) overall higher administrative expenses, including medical expenses due to increased claims in the current year.

For the full year, our 2006 SG&A expenses as a percentage of total revenues are currently expected to increase approximately 150 basis points, due in part to an expected increase of \$20.0 million in national advertising expenditures in the fourth quarter of 2006. In addition, impacting 2006 are the costs associated with the closing of our manufacturing facility in Ozark, Alabama in May 2006 and the February 2006 departure of Mark Weber, our former Chief Executive Officer of \$11.3 million and \$10.5 million, respectively. We estimate that noncash stock option expense for the full year 2006 will be approximately \$8.0 million. Partially offsetting these items will be expense savings in 2006 of approximately \$9.0 million due to the closure at the end of 2005 of our *Calvin Klein Collection* stores in Dallas and Paris.

Gain on Sale of Investment

In the first quarter of 2006, we sold minority interests held by one of our subsidiaries in certain entities that operate the licenses and related wholesale and retail businesses of *Calvin Klein* jeans and accessories in Europe and Asia and the *ck Calvin Klein* bridge line of sportswear and accessories in Europe. The sale resulted in a pre-tax gain of \$32.0 million, which is net of related fees, amounts held in escrow and the carrying value of the investment.

Interest Expense, Net

The majority of our interest expense relates to our fixed rate long-term debt. As a result, variances in our net interest expense tend to be driven by changes in interest income and, to a lesser extent, costs related to our revolving credit facility.

Net interest expense in the first nine months of 2006 was \$13.9 million compared with \$22.6 million in the prior year. The net interest expense decrease was due principally to an increase in interest income from our higher cash position and an increase in investment rates of return over the prior year.

Income Taxes

Income taxes for the current year are estimated at a rate of 37.1%, compared with last year's full year rate of 37.3%.

Net Income per Common Share

Our calculation of net income per common share for the thirty-nine weeks ended October 30, 2005 was impacted by the voluntary conversion of a portion of our Series B convertible preferred stock by the holders of such stock into shares of our common stock. Such shares of common stock were subsequently sold in a registered offering by the holders in July 2005. In connection with these transactions, we made an inducement payment to the preferred stockholders of \$1.75 for each share of common stock sold, or an aggregate of \$12.9 million, and incurred certain costs, totaling \$1.3 million, specifically related to the registered common stock offering. The inducement payment was based on the net present value of the dividends that we would have been obligated to pay the preferred stockholders through the earliest date on which it was estimated that we would have had the right to convert the Series B convertible preferred stock, net of the net present value of the dividends payable over the same period on the shares of common stock into which the Series B convertible preferred stock was convertible. In accordance with accounting principles generally accepted in the United States, the portion of the Series B convertible preferred stock that was converted was considered separately from the portion of the Series B convertible preferred stock that was not converted for purposes of our net income per common share calculation. Further, the aggregate \$14.2 million inducement payment and offering costs was treated as a preferred stock dividend and attributed to the portion of the Series B convertible preferred stock that was converted.

Our calculation of net income per common share for the thirty-nine weeks ended October 29, 2006 was impacted by the voluntary conversion in May 2006 of all of the remaining outstanding shares of the Series B convertible preferred stock by the holders of such stock into shares of common stock. The holders sold the majority of such shares in a registered common stock offering. In connection with the conversion, we made an inducement payment to the preferred stockholders of \$0.88 for each share of common stock received upon conversion, or an aggregate of \$10.2 million, and incurred certain costs, totaling \$0.7 million, specifically related to the registered common stock offering. The inducement payment was based on the net present value of the dividends that we would have been obligated to pay the preferred stockholders through the earliest date on which it was estimated that we would have had the right to convert the Series B convertible preferred stock, net of the net present value of the dividends payable over the same period on the shares of common stock into which the Series B convertible preferred stock was convertible. In accordance with accounting principles generally accepted in the United States, the aggregate \$10.9 million inducement payment and offering costs was treated as a preferred stock dividend and attributed to the Series B convertible preferred stock for purposes of our net income per common share calculation.

Note 10, Net Income per Common Share, in the Notes to Condensed Consolidated Financial Statements includes a further explanation and the calculations of basic and diluted net income per common share.

LIQUIDITY AND CAPITAL RESOURCES

Generally, our principal source of cash is from operations, and our principal uses of cash are for capital expenditures, contingent purchase price payments to Mr. Calvin Klein and dividends.

Operations

Cash provided by operating activities was \$112.4 million in the first nine months of 2006 compared with \$82.2 million in the prior year. This increase was due principally to changes in working capital, including a reduction in accounts receivable as a result of strong collections in the third quarter of 2006.

We currently expect that our cash provided by operating activities in 2006 will approximate the prior year amount of \$189.4 million. We anticipate that an increase in net income, adjusted for depreciation, amortization, stock-based compensation and the pre-tax gain on the sale of investment will be mostly offset by increases in working capital and income tax payments due to exhausting certain net operating loss tax carryforwards.

Capital Expenditures

Our capital expenditures in the first nine months of 2006 were \$26.4 million. We currently expect that capital expenditures in 2006 will be in a range of \$40 million to \$45 million. Our capital expenditures are generally for information systems, warehouse and office facilities and outlet retail stores. As such, we have no long-term contractual commitments for capital expenditures.

Contingent Purchase Price Payments

In connection with our acquisition of Calvin Klein, we are obligated to pay Mr. Calvin Klein contingent purchase price payments through 2017 based on 1.15% of total worldwide net sales of products bearing any of the *Calvin Klein* brands. Such contingent purchase price payments are recorded as additions to goodwill and totaled \$21.1 million in the first nine months of 2006. We currently expect that such payments will be \$27.0 million to \$29.0 million in 2006.

Sale of Investment

In the first quarter of 2006, we sold minority interests held by one of our subsidiaries in certain entities that operate the licenses and related wholesale and retail businesses of *Calvin Klein* jeans and accessories in Europe and Asia and the *ck Calvin Klein* bridge line of sportswear and accessories in Europe. We received \$32.8 million in cash proceeds from the sale of these entities.

Dividends

Preferred stock dividends totaled \$3.2 million for the first nine months of 2006.

In May 2006, the holders of our Series B convertible preferred stock voluntarily converted all of the remaining outstanding shares of Series B convertible preferred stock into 11.6 million shares of our common stock. In connection with the conversion, we made an inducement payment to the preferred stockholders of \$0.88 for each share of common stock received upon conversion, or an aggregate of \$10.2 million, and incurred certain costs, totaling \$0.7 million, in connection with the registered common stock offering. The inducement payment was based on the net present value of the preferred dividends that we would have been obligated to pay the holders through the earliest date on which it was estimated that we would have had the right to convert the Series B convertible preferred stock, net of the net present value of the dividends payable over the same period on the shares of common stock into which the Series B convertible preferred stock was convertible. Under accounting principles generally accepted in the United States, the aggregate \$10.9 million inducement payment and offering costs was treated similar to a preferred stock

dividend in the second quarter of 2006.

Our common stock currently pays annual dividends totaling \$0.15 per share. Cash dividends on our common stock in 2006 are expected to approximate \$7.9 million.

Cash Flow Summary

Our net cash flow in the first nine months of 2006 was \$91.2 million. Cash flow in 2006 will be impacted by various other factors in addition to those noted above. The exercise of stock options provided \$52.6 million of cash for the full year in 2005. We currently estimate that 2006 will include \$10.0 million to \$15.0 million of cash from the exercise of stock options. In connection with the closing of our manufacturing facility in Ozark, Alabama, we expect cash outflows to approximate \$10.0 million in 2006 for severance, employee termination benefits and facility closing costs. In addition, in connection with the departure of Mark Weber, our former Chief Executive Officer, we expect cash outflows to approximate \$10.0 million in 2006.

Based on our current operations, considering all of the above factors and excluding our anticipated acquisition of Superba effective on January 1, 2007 for \$110.0 million, we currently expect to generate \$135.0 million to \$145.0 million of cash flow in 2006.

Financing Arrangements

Our capital structure as of October 29, 2006 was as follows:

(in millions)

| | |
|----------------------|---------|
| Long-term debt | \$399.5 |
| Stockholders' equity | 903.4 |

We believe our capital structure provides a secure base to support our current operations and our planned growth in the future. There are no maturities of our long-term debt until 2011.

For near-term liquidity, in addition to our cash balance, we have a \$325.0 million secured revolving credit facility that provides for revolving credit borrowings, as well as the issuance of letters of credit. We may, at our option, borrow and repay amounts up to a maximum of \$325.0 million for revolving credit borrowings and the issuance of letters of credit, with a sublimit of \$30.0 million for standby letters of credit and with no sublimit on trade letters of credit. Based on our working capital projections, we believe that our borrowing capacity under this facility provides us with adequate liquidity for our peak seasonal needs for the foreseeable future. During the first nine months of 2006, we had no revolving credit borrowings under the facility, and the maximum amount of letters of credit outstanding was \$189.2 million. As of October 29, 2006, we had \$118.0 million outstanding letters of credit under this facility. We currently do not expect to have any revolving credit borrowings under the facility in 2006.

Given our capital structure and our projections for future profitability and cash flow, we believe we could obtain additional financing, if necessary, for refinancing our long-term debt, or, if opportunities present themselves, future acquisitions.

SEASONALITY

Our business generally follows a seasonal pattern. Our wholesale dress shirt and sportswear businesses tend to generate higher levels of sales and income in the first and third quarters, as the selling of Spring and Fall merchandise to our customers occurs at higher levels as these selling seasons begin. Our retail businesses tend to generate higher levels of sales and income in the third and fourth quarters, due to the back to school and holiday selling seasons. Royalty, advertising and other revenues tend to be earned somewhat evenly throughout the year. The third quarter has

the highest level of royalty income, due to higher sales by licensees in advance of the holiday selling season.

Due to the above factors, our operating results for the thirteen and thirty-nine week periods ended October 29, 2006 are not necessarily indicative of those for a full fiscal year.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Financial instruments held by us include cash equivalents and long-term debt. Interest rates on our long-term debt are fixed. Therefore, a change in rates generally would not have an effect on our interest expense. Note 7, Long-Term Debt, in the Notes to the Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K as amended for the year ended January 29, 2006 outlines the principal amounts, interest rates, fair values and other terms required to evaluate the expected sensitivity of interest rate changes on the fair value of our fixed rate long-term debt. Cash equivalents held by us are affected by short-term interest rates. Therefore, a change in short-term interest rates would have an impact on our interest income. Given our balance of cash and cash equivalents as of October 29, 2006, the effect of a 50 basis point change in short-term interest rates on our interest income would be approximately \$1.8 million annually.

Principally all of our revenues and expenses are currently denominated in United States dollars. However, certain of our operations and license agreements expose us to fluctuations in foreign currency exchange rates, primarily the rate of exchange of the United States dollar against the Euro, the Yen and the Canadian dollar. Our principal exposure to changes in exchange rates for the United States dollar results from our licensing business. Many of our license agreements require the licensee to report sales to us in the licensee's local currency but to pay us in United States dollars based on the exchange rate as of the last day of the contractual selling period. Thus, while we are not exposed

to exchange rate gains and losses between the end of the selling period and the date we collect payment, we are exposed to exchange rate changes during and up to the last day of the selling period. During times of a strengthening United States dollar, our foreign royalty revenues will be negatively impacted, and during times of a weakening United States dollar, our foreign royalty revenues will be favorably impacted. Our secondary exposure to changes in exchange rates for the United States dollar results from our foreign wholesale operations. During 2006, we expanded our wholesale operations to include sales to department and specialty stores throughout Canada and parts of Europe. Sales for these foreign operations are both generated and collected in foreign currency, which exposes us to foreign exchange gains and losses between the date of the sale and the date we collect payment because the majority of our cash from our foreign wholesale operations is converted to United States dollars after collection. Therefore, the results of these operations will be negatively impacted during times of a strengthening United States dollar and favorably impacted during times of a weakening United States dollar.

Not all foreign license agreements expose us to foreign exchange risk. Many of our foreign license agreements specify that contractual minimums be paid in United States dollars. Thus, for these foreign license agreements where the licensee's sales do not exceed contractual minimums, the licensee assumes the risk of changes in exchange rates and we do not.

Also somewhat mitigating our exposure to changes in the exchange rate for the Euro is our Calvin Klein administrative office in Milan, Italy. During times of a strengthening United States dollar against the Euro, our Milan expenses will be favorably impacted, and during times of a weakening United States dollar against the Euro, our Milan expenses will be negatively impacted.

Due to the overall immateriality of our foreign operations, changes in the exchange rate for the United States dollar have not had a material effect on our consolidated results of operations or financial position.

ITEM 4 - CONTROLS AND PROCEDURES

As of October 29, 2006, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures over financial reporting. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures over financial reporting were effective as of October 29, 2006. Disclosure controls and procedures over financial reporting are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in our internal control over financial reporting during the period to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1A - RISK FACTORS

On May 10, 2006, affiliates of the holders of our Series B convertible preferred stock acquired Tommy Hilfiger Corporation and the holders' sole remaining director resigned from our Board of Directors. On May 12, 2006, the holders of our Series B convertible preferred stock converted all of the remaining outstanding shares of Series B convertible preferred stock into shares of our common stock. A substantial portion of the shares of common stock issued upon conversion was subsequently sold in a registered offering by the holders, the converted shares of Series B convertible preferred stock returned to the status of undesignated shares of our authorized preferred stock and the Investors' Rights Agreement to which we were a party with such holders was terminated. Therefore, the following risk factor, which was included in our Annual Report on Form 10-K for the year ended January 29, 2006, is no longer applicable:

Significant influence by certain stockholders.

In connection with our acquisition of Calvin Klein, affiliates of Apax Managers, Inc. and Apax Partners Europe Managers Limited purchased \$250 million of our Series B convertible preferred stock. During 2005, the Apax affiliates voluntarily converted a portion of such Series B convertible preferred stock, as further discussed in Note 10, Series B Convertible Preferred Stock, in the Notes to the Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended January 29, 2006. As of January 29, 2006, the remaining Series B convertible preferred stock held by the Apax affiliates had liquidation preference of \$161.9 million and was convertible by them into 21.1% of our outstanding common stock. If we elect not to pay a cash dividend for any quarter, then the Series B convertible preferred stock will be treated for purposes of the payment of future dividends and upon conversion, redemption or liquidation as if an in-kind dividend has been paid.

Pursuant to the Investors' Rights Agreement we have with the Apax affiliates, the holders of our Series B convertible preferred stock are generally prohibited from initiating a takeover of us. In certain circumstances, the Apax affiliates may be able to participate in a bidding process initiated by a third party. As long as Apax affiliates own at least 50% of the shares of our Series B convertible preferred stock initially sold to the Apax affiliates, they will have the ability to prevent a change of control, or a sale of all or substantially all of our assets. As of January 29, 2006, the Apax affiliates owned approximately 61% of the shares of our Series B convertible preferred stock initially issued to them. Additionally, as long as 50% of our Series B convertible preferred stock remains outstanding, the holders of our Series B convertible preferred stock will have a right to purchase their pro rata share of newly issued securities. The holders of our Series B convertible preferred stock have certain additional rights, including the right to approve the issuance of certain new series of our preferred stock, which could also have the effect of discouraging a third party from pursuing a non-negotiated takeover, and preventing changes in control, of us.

Prior to the conversion of a portion of our Series B convertible preferred stock during 2005, the Apax affiliates had the right to elect separately as a class three directors and to have one of their directors serve on the audit, compensation, nominating and executive committees of our board, subject to applicable law, rule and regulation; current regulation precludes service on the audit committee. In connection with the conversion, the remaining preferred stockholders agreed to reduce their right to elect directors from three directors to two directors and to further reduce this right to one director if they did not have more than one director elected as of December 31, 2005. The remaining preferred stockholders did not elect an additional director as of December 31, 2005 and, as such, only one such director can be and is currently elected. If the Apax affiliates continue to own at least 10% of the Series B convertible preferred stock issued in connection with the acquisition of Calvin Klein they will maintain their right to elect separately as a class one director. However, the right of the Series B convertible preferred stockholders to elect a director will be terminated if the previously announced acquisition of Tommy Hilfiger Corporation by certain affiliates of the Apax affiliates is consummated. As a result of these and other rights related to their ownership of our Series B convertible preferred stock, the Apax affiliates have substantial influence over us.

The interests of the Apax affiliates or the holders of Series B convertible preferred stock may at any time conflict with, or diverge from, those of our other stockholders. The Apax affiliates or such other Series B convertible preferred stockholders, by virtue of their large percentage of voting rights and the terms of the Series B convertible preferred stock, will be able to substantially influence, and may effectively be able to prevent or veto, certain corporate actions, such as the sale of our company, the issuance of a new class or series of our stock in connection with a corporate transaction or other major corporate action.

ITEM 6 - EXHIBITS

The following exhibits are included herein:

- 3.1 Certificate of Incorporation (incorporated by reference to Exhibit 5 to the Company's Annual Report on Form 10-K for the fiscal year ended January 29, 1977).
- 3.2 Amendment to Certificate of Incorporation, filed June 27, 1984 (incorporated by reference to Exhibit 3B to the Company's Annual Report on Form 10-K for the fiscal year ended February 3, 1985).
- 3.3 Certificate of Designation of Series A Cumulative Participating Preferred Stock, filed June 10, 1986 (incorporated by reference to Exhibit A of the document filed as Exhibit 3 to the Company's Quarterly Report on Form 10-Q for the period ended May 4, 1986).
- 3.4 Amendment to Certificate of Incorporation, filed June 2, 1987 (incorporated by reference to Exhibit 3(c) to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1988).
- 3.5 Amendment to Certificate of Incorporation, filed June 1, 1993 (incorporated by reference to Exhibit 3.5 to the Company's Annual Report on Form 10-K for the fiscal year ended January 30, 1994).
- 3.6 Amendment to Certificate of Incorporation, filed June 20, 1996 (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended July 28, 1996).
- 3.7 Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock of Phillips-Van Heusen Corporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, filed on February 26, 2003).
- 3.8 Corrected Certificate of Designations, Preferences and Rights of Series B Convertible Preferred Stock of Phillips-Van Heusen Corporation, dated as of April 17, 2003 (incorporated by reference to Exhibit 3.9 to the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 2003).

- 3.9 By-laws of Phillips-Van Heusen Corporation, as amended through March 3, 2005 (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, filed on March 8, 2005).
- 4.1 Specimen of Common Stock certificate (incorporated by reference to Exhibit 4 to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1981).
- 4.2 Preferred Stock Purchase Rights Agreement (the Rights Agreement), dated as of June 10, 1986, between Phillips-Van Heusen Corporation and The Chase Manhattan Bank, N.A. (incorporated by reference to Exhibit 3 to the Company's Quarterly Report on Form 10-Q for the period ended May 4, 1986).
- 4.3 Amendment to the Rights Agreement, dated as of March 31, 1987, between Phillips-Van Heusen Corporation and The Chase Manhattan Bank, N.A. (incorporated by reference to Exhibit 4(c) to the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 1987).
- 4.4 Supplemental Rights Agreement and Second Amendment to the Rights Agreement, dated as of July 30, 1987, between Phillips-Van Heusen Corporation and The Chase Manhattan Bank, N.A. (incorporated by reference to Exhibit (c)(4) to the Company's Schedule 13E-4, Issuer Tender Offer Statement, dated July 31, 1987).
- 4.5 Third Amendment to the Rights Agreement, dated as of June 30, 1992, among Phillips-Van Heusen Corporation, The Chase Manhattan Bank, N.A. and The Bank of New York (incorporated by reference to Exhibit 4.5 to the Company's Quarterly Report on Form 10-Q for the period ended April 30, 2000).
- 4.6 Notice of extension of the Rights Agreement, dated as of June 5, 1996, between Phillips-Van Heusen Corporation and The Bank of New York (incorporated by reference to Exhibit 4.13 to the Company's Quarterly Report on Form 10-Q for the period ended April 28, 1996).

- 4.7 Fourth Amendment to the Rights Agreement, dated as of April 25, 2000, between Phillips-Van Heusen Corporation and The Bank of New York (incorporated by reference to Exhibit 4.7 to the Company's Quarterly Report on Form 10-Q for the period ended April 30, 2000).
- 4.8 Supplemental Rights Agreement and Fifth Amendment to the Rights Agreement, dated as of February 12, 2003, between Phillips-Van Heusen Corporation and The Bank of New York (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K, filed on February 26, 2003).
- 4.9 Indenture, dated as of November 1, 1993, between Phillips-Van Heusen Corporation and The Bank of New York, as Trustee (incorporated by reference to Exhibit 4.01 to the Company's Registration Statement on Form S-3 (Reg. No. 33-50751) filed on October 26, 1993).
- 4.10 First Supplemental Indenture, dated as of October 17, 2002, to Indenture, dated as of November 1, 1993, between Phillips-Van Heusen Corporation and The Bank of New York, as Trustee (incorporated by reference to Exhibit 4.15 to the Company's Quarterly Report on Form 10-Q for the period ended November 3, 2002).
- 4.11 Second Supplemental Indenture, dated as of February 12, 2002, to Indenture, dated as of November 1, 1993, between Phillips-Van Heusen Corporation and the Bank of New York, as Trustee (incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K, filed on February 26, 2003).
- 4.12 Indenture, dated as of May 5, 2003, between Phillips-Van Heusen Corporation and SunTrust Bank, as Trustee (incorporated by reference to Exhibit 4.13 to the Company's Quarterly Report on Form 10-Q for the period ended May 4, 2003).
- 4.13 Indenture, dated as of February 18, 2004, between Phillips-Van Heusen Corporation and SunTrust Bank, as Trustee (incorporated by reference to Exhibit 4.14 to the Company's Annual Report on Form 10-K for the fiscal year ended February 1, 2004).
- +10.1 Phillips-Van Heusen Corporation 2006 Stock Incentive Plan, effective as of April 27, 2006, as amended through September 21, 2006.

- +10.2 Phillips-Van Heusen Corporation 1997 Stock Option Plan, effective as of April 29, 1997, as amended through September 21, 2006.
- +10.3 Phillips-Van Heusen Corporation 2000 Stock Option Plan, effective as of April 27, 2000, as amended through September 21, 2006.
- +10.4 Phillips-Van Heusen Corporation 2003 Stock Option Plan, effective as of May 1, 2003, as amended through September 21, 2006.
- 10.5 Asset Purchase Agreement, dated October 11, 2006, among Phillips-Van Heusen Corporation, Superba, Inc. and A. Mervyn Mandelbaum (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K/A, filed on October 13, 2006).
- +15 Acknowledgement of Independent Registered Public Accounting Firm.
- +31.1 Certification of Emanuel Chirico, Chief Executive Officer, pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
- +31.2 Certification of Michael Shaffer, Executive Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
- +32.1 Certification of Emanuel Chirico, Chief Executive Officer, pursuant to Section 906 of the Sarbanes Oxley Act of 2002, 18 U.S.C. Section 1350.
- +32.2 Certification of Michael Shaffer, Executive Vice President and Chief Financial Officer, pursuant to Section 906 of the Sarbanes Oxley Act of 2002, 18 U.S.C. Section 1350.

+ Filed herewith.

Exhibits 32.1 and 32.2 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section. Such exhibits shall not be deemed incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PHILLIPS-VAN HEUSEN CORPORATION

Registrant

Dated: December 7, 2006

/s/ Bruce Goldstein

Bruce Goldstein

Vice President and Controller

(Chief Accounting Officer)