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STEVEN MADDEN, LTD.  
Form 10-Q  
May 10, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2006

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 0-23702

STEVEN MADDEN, LTD.

(Exact name of Registrant as specified in its charter)

Delaware

13-3588231

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

52-16 Barnett Avenue, Long Island City, New York

11104

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code

(718) 446-1800

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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  No

As of May 4, 2006 there were 13,873,667 shares of the registrant's common stock, \$.0001 par value, outstanding.

STEVEN MADDEN, LTD.  
FORM 10-Q

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QUARTERLY REPORT  
March 31, 2006

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### PART I. FINANCIAL INFORMATION

#### Item 1. Condensed Consolidated Financial Statements

#### STEVEN MADDEN, LTD. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets  
(in thousands)

|   | March 31,<br>2006 | December 31,<br>2005 |
|---|-------------------|----------------------|
|   | -----             | -----                |
|   | (unaudited)       |                      |
| ASSETS  |                   |                      |
| Current assets:   |                   |                      |
| Cash and cash equivalents   | \$ 24,121         | \$ 42,842            |
| Accounts receivable, net of allowances of \$1,864, \$813 and \$640  | 5,034             | 3,294                |
| Due from factor, net of allowances of \$10,151, \$7,587 and \$3,164 | 54,687            | 31,785               |
| Inventories   | 36,579            | 28,412               |
| Marketable securities - available for sale                          | 14,761            | 24,092               |
| Prepaid expenses and other current assets                           | 6,295             | 2,435                |
| Prepaid taxes   | --                | 2,512                |

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|   |            |            |
|---|------------|------------|
| Deferred taxes  | 5,526      | 5,600      |
|   | -----      | -----      |
| Total current assets  | 147,003    | 140,972    |
| Property and equipment, net   | 21,128     | 20,898     |
| Deferred taxes  | 5,478      | 5,568      |
| Deposits and other  | 848        | 586        |
| Marketable securities - available for sale  | 40,147     | 42,157     |
| Goodwill - net  | 6,719      | 1,547      |
| Intangibles - net   | 8,172      | --         |
|   | -----      | -----      |
| Total Assets  | \$ 229,495 | \$ 211,728 |
|   | =====      | =====      |
| LIABILITIES   |            |            |
| Current liabilities:  |            |            |
| Accounts payable  | \$ 16,995  | 15,579     |
| Accrued expenses  | 19,168     | 11,327     |
|   | -----      | -----      |
| Total current liabilities   | 36,163     | 26,906     |
| Deferred rent   | 3,391      | 2,757      |
|   | -----      | -----      |
|   | 39,554     | 29,663     |
|   | -----      | -----      |
| Commitments, contingencies and other  |            |            |
| STOCKHOLDERS' EQUITY  |            |            |
| Preferred stock - \$.0001 par value, 5,000 shares authorized;<br>none issued; Series A Junior Participating preferred stock -<br>\$.0001 par value, 60 shares authorized; none issued |            |            |
| Common stock - \$.0001 par value, 60,000 shares authorized, 16,255,<br>16,150 and 15,228 shares issued, 13,874, 13,916 and<br>13,129 outstanding                                      |            |            |
|   | 2          | 2          |
| Additional paid-in capital  | 101,547    | 99,950     |
| Retained earnings   | 119,698    | 108,838    |
| Unearned compensation   | --         | --         |
| Other comprehensive gain:   |            |            |
| Unrealized gain on marketable securities (net of taxes)   | (1,073)    | (1,299)    |
| Treasury stock - 2,381, 2,234 and 2,099 shares at cost  | (30,233)   | (25,426)   |
|   | -----      | -----      |
|   | 189,941    | 182,065    |
|   | -----      | -----      |
| Total Liabilities and Stockholders' Equity  | \$ 229,495 | \$ 211,728 |
|   | =====      | =====      |

See accompanying notes to condensed consolidated financial statements - unaudited

STEVEN MADDEN, LTD. AND SUBSIDIARIES

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

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|  | Three Months Ended<br>March 31, |           |
|--|---------------------------------|-----------|
|  | 2006                            | 2005      |
| Net sales:   |                                 |           |
| Wholesale  | \$ 82,982                       | \$ 56,861 |
| Retail   | 25,333                          | 26,475    |
|  | -----                           | -----     |
|  | 108,315                         | 83,336    |
|  | -----                           | -----     |
| Cost of sales:   |                                 |           |
| Wholesale  | 48,857                          | 41,441    |
| Retail   | 13,175                          | 14,543    |
|  | -----                           | -----     |
|  | 62,032                          | 55,984    |
|  | -----                           | -----     |
| Gross profit:  |                                 |           |
| Wholesale  | 34,125                          | 15,420    |
| Retail   | 12,158                          | 11,932    |
|  | -----                           | -----     |
|  | 46,283                          | 27,352    |
| Commission and licensing fee income - net                | 3,762                           | 1,225     |
| Operating expenses                                       | (31,590)                        | (27,356)  |
|  | -----                           | -----     |
| Income from operations                                   | 18,455                          | 1,221     |
| Interest and other income, net                           | 271                             | 438       |
|  | -----                           | -----     |
| Income before provision for income taxes                 | 18,726                          | 1,659     |
| Provision for income taxes                               | 7,866                           | 697       |
|  | -----                           | -----     |
| Net income   | \$ 10,860                       | \$ 962    |
|  | =====                           | =====     |
| Basic income per share                                   | \$ 0.78                         | \$ 0.07   |
|  | =====                           | =====     |
| Diluted income per share                                 | \$ 0.74                         | \$ 0.07   |
|  | =====                           | =====     |
| Basic weighted average common shares outstanding         | 13,917                          | 13,235    |
| Effect of dilutive securities - options/restricted stock | 695                             | 569       |
|  | -----                           | -----     |
| Diluted weighted average common shares outstanding       | 14,612                          | 13,804    |
|  | =====                           | =====     |

See accompanying notes to condensed consolidated financial statements - unaudited 2

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STEVEN MADDEN, LTD. AND SUBSIDIARIES

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

Cash flows from operating activities:

Net income

Adjustments to reconcile net income to net cash provided by (used in) operating activities:

Depreciation and amortization

Loss on disposal of fixed assets

Non-cash compensation

Provision for doubtful accounts and chargebacks

Deferred rent expense

Realized loss on sale of marketable securities

Changes in:

Accounts receivable

Due from factor

Inventories

Prepaid expenses, prepaid taxes, deposits and other assets

Accounts payable and other accrued expenses

Net cash provided by (used in) operating activities

Cash flows from investing activities:

Purchases of property and equipment

Purchases of marketable securities

Sale/redemption of marketable securities

Acquisition, net of cash acquired

Net cash used in investing activities

Cash flows from financing activities:

Proceeds from exercise of stock options

Common stock purchased for treasury

Net cash used in financing activities

Net decrease in cash and cash equivalents

Cash and cash equivalents - beginning of period

Cash and cash equivalents - end of period

See accompanying notes to condensed consolidated financial statements - unaudited

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STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited  
March 31, 2006  
(\$ in thousands except per share data)

### Note A - Basis of Reporting

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, such statements include all adjustments (consisting only of normal recurring items) which are considered necessary for a fair presentation of the financial position of Steven Madden, Ltd. and subsidiaries (the "Company") and the results of its operations and cash flows for the periods presented. The results of its operations for the three-month period ended March 31, 2006 are not necessarily indicative of the operating results for the full year. It is suggested that these financial statements be read in conjunction with the financial statements and related disclosures for the year ended December 31, 2005 included in the Annual Report of Steven Madden, Ltd. on Form 10-K filed with the SEC on March 14, 2006.

### Note B - Use of Estimates

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

Allowances for bad debts, returns and customer chargebacks: The Company provides reserves on trade accounts receivables for future customer chargebacks and markdown allowances, discounts, returns and other miscellaneous compliance related deductions that relate to the current period sales. As a result of a reevaluation of the retail environment, the Company has revised its method for evaluating its estimate of the allowance for customer chargebacks beginning in the fourth quarter of 2005. In the past, the Company looked at historical dilution levels for customers to determine the allowance amount. Under the new method of estimation, the Company evaluates anticipated chargebacks by reviewing several performance indicators of its major customers. These performance indicators, which include inventory levels, sell through rates and gross margin levels, are analyzed by key account executives to estimate the amount of the anticipated customer allowance.

### Note C - Marketable Securities

Marketable securities consist primarily of corporate bonds, U.S. treasury notes and government asset-backed securities with maturities greater than three months and up to five years at the time of purchase as well as marketable equity securities. These securities, which are classified as available-for-sale, are carried at fair value, with unrealized gains and losses, net of any tax effect, reported in shareholders' equity as accumulated other comprehensive income (loss). Amortization of premiums and discounts are included in interest income and are not material. The values of these securities may fluctuate as a result

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of changes in market interest rates and credit risk.

### Note D - Inventories

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

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited

March 31, 2006

(\$ in thousands except per share data)

### Note E - Revenue Recognition

The Company recognizes revenue on wholesale sales when products are shipped pursuant to our standard terms which are freight on board (FOB) warehouse or when products are delivered to the consolidators as per the terms of the customers purchase order. Sales reductions for anticipated discounts, allowances and other deductions are recognized when sales are recorded. Customers retain the right to replacement of the product for poor quality or improper or short shipments, which have historically been immaterial. Retail sales are recognized when the payment is received from customers and are recorded net of returns. The Company earns commission income as a buying agent through its Adesso-Madden Division by arranging to produce private label shoes to the specifications of its clients. In addition, the Company has leveraged the strength of its Steve Madden brands and product designs resulting in a partial recovery of its design, product and development costs from its suppliers. Commission revenue and product and development cost recoveries are recognized as earned when title of the product transfers from the manufacturer to the customer and is reported on a net basis after deducting operating expenses.

The Company licenses its Steve Madden trademark for use in connection with the manufacturing, marketing and sale of sunglasses, eyewear and hosiery products. Each license agreement requires the licensee to pay to the Company a royalty and advertising fee based on net sales as defined in the various agreements. A minimum royalty and advertising fee is due the Company in the event that specified net sales targets are not achieved. Licensing revenue is recognized on the basis of net sales reported by the licensees or, if greater, minimum guaranteed royalties when earned. In substantially all of the Company's license agreements, the minimum guaranteed royalty is earned and payable on a quarterly basis.

### Note F - Sales Deductions

The Company supports retailers' initiatives to maximize the sales of its products on the retail floor by subsidizing the co-op advertising programs of such retailers, providing them with inventory markdown allowances and participating in various other marketing initiatives of its major customers. Such expenses are reflected in the Condensed Consolidated Statement of Operations as deductions to net sales. For the three-month periods ended March 31, 2006 and 2005, the total deduction to net sales for these expenses was \$6,871 and \$8,516, respectively.

### Note G - Cost of Sales

All costs incurred to bring finished products to the Company's distribution center are included in the cost of sales line item on the Condensed Consolidated

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Statement of Operations. These include purchase commissions, letter of credit fees, brokerage fees, material and labor and related items, sample expenses, custom duty, inbound freight, royalty payments, labels and product packaging. All warehouse and distribution costs are included in the operating expenses line item of the Company's Condensed Consolidated Statement of Operations. The Company classifies all shipping costs to customers as operating expenses. The Company's gross margins may not be comparable to other companies in the industry because some companies may include warehouse and distribution as a component of cost of sales, while other companies report on the same basis as the Company and include them in operating expenses.

### Note H - Stock Incentive Plan

In March of 2006, the Board of Directors approved the Steven Madden, Ltd. Stock Incentive Plan (the "Plan") under which nonqualified stock options, stock appreciation rights, performance shares, restricted stock, other stock-based awards and performance-based cash awards may be granted to employees, consultants and non-employee directors. The Board's adoption of the Plan is subject to shareholder approval. The number of shares that may be issued or used under the Plan cannot exceed 800,000 shares. On March 20, 2006, subject to shareholder approval, the Company awarded 120,800 restricted stock shares to employees and directors that will, with some exceptions, vest annually in equal parts over four years. The compensation associated with the restricted stock will be valued based on the closing price of the Company's common stock on the date of shareholder approval.

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## STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited  
March 31, 2006  
(\$ in thousands except per share data)

### Note I - Reclassification

The Company has reclassified royalty payments on its Condensed Consolidated Statement of Operations from operating expenses to cost of sales. This reclassification resulted in an increase in the cost of sales for the three months ended March 31, 2006 and 2005 of \$879 and \$966, respectively, with a corresponding decrease to operating expenses in the same periods. This reclassification had no impact on the net income of the Company.

Revision in the Classification of Auction Rate Bonds. During the first quarter of 2006, the Company revised its presentation of its auction rate bonds to short-term investments. Previously, such investments had been classified as cash and cash equivalents. Accordingly, the company has revised the classification to report these securities as short-term investments on its Consolidated Balance Sheet as of December 31, 2005. As previously reported at December 31, 2005, \$10,000 of these auction rate municipal bonds were classified as cash and cash equivalents on the Company's Consolidated Balance Sheet.

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

Basic income per share is based on the weighted average number of common shares outstanding during the period. Diluted income per share reflects the potential dilution assuming common shares were issued upon the exercise of outstanding options and the proceeds thereof were used to purchase outstanding common shares. Diluted income per share also reflects the unvested and unissued shares promised to employees which have a dilutive effect. For the purposes of

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calculating the diluted income per share for the three months ended March 31, 2006 and 2005, stock options representing approximately none and 1,202,000, respectively, have been excluded because including the shares would be anti-dilutive.

### Note K - Stock-Based Compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123R, "Accounting for Stock-Based Compensation" ("SFAS No. 123R"), which requires stock-based compensation to be measured based on the fair value of the awards on the grant date. The Company elected the "modified prospective method" of transition as permitted by SFAS No. 123R. Under this transition method, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that were outstanding at the date of adoption, and accordingly, periods prior to adoption are not restated. For the three-month period ended March 31, 2006, total equity-based compensation of \$60 related to stock options previously granted was included in operating expense. As of March 31, 2006, unrecognized equity-based compensation is \$60, which will be recognized in the quarter ended June 30, 2006. The equity-based compensation for the periods ended March 31 and June 30, 2006 relate to one employee, and thus no forfeitures were assumed in estimating the amount of compensation expense.

Prior to the adoption of FAS No. 123R, the Company presented cash flows resulting from the tax benefits of deductions from the exercise of stock options as operating cash flows in the Statements of Cash Flows. FAS No. 123R requires cash flows resulting from the tax benefits from tax deduction in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The Company did not realize any tax benefits from the exercise of stock options during the three months ended March 31, 2006.

The weighted average fair value of options granted in 2005 was approximately \$6.11 using the Black-Scholes option-pricing model assuming a volatility of 43%, risk free interest rate of 3.86%, an expected life of 3 years and no dividend yield.

There were 85,000 options exercised during the three months ended March 31, 2006 with a total intrinsic value of \$1,537. During the three months ended March 31, 2006, 10,000 options vested with a weighted average exercise price of \$17.76. As of March 31, 2006, there were 10,000 unvested options with a weighted average exercise price of \$17.76, which will vest during the quarter ended June 30, 2006.

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### STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited  
March 31, 2006  
(\$ in thousands except per share data)

### Note K - Stock-Based Compensation (continued)

Prior to adopting SFAS No. 123R, the Company's equity-based compensation expense was accounted for under the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees", as permitted by SFAS No. 123. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provision of SFAS No. 123R to equity-based employee compensation for the period ended March 31, 2005:

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|  |    |       |
|--|----|-------|
| Reported net income  | \$ | 962   |
| Stock-based employee compensation included in reported net income, net of tax              |    | 82    |
| Stock-based employee compensation determined under the fair value based method, net of tax |    | (538) |
|  |    | ----- |
| Pro forma net income   | \$ | 506   |
|  |    | ===== |
| Basic income per share:  |    |       |
| As reported  | \$ | 0.07  |
| Pro forma  | \$ | 0.04  |
| Diluted income per share:  |    |       |
| As reported  | \$ | 0.07  |
| Pro forma  | \$ | 0.04  |

Activity relating to stock options granted under the Company's plans and outside the plans during the quarters ended March 31, is as follows:

|                          | 2006                |  | 2005                |  |
|--------------------------|---------------------|--|---------------------|--|
|                          | Number<br>of Shares | Weighted<br>Average<br>Exercise<br>Price | Number<br>of Shares | Weighted<br>Average<br>Exercise<br>Price |
|                          | -----               | -----                                    | -----               | -----                                    |
| Outstanding at January 1 | 1,300,000           | \$ 12.71                                 | 2,513,000           | \$ 12.71                                 |
| Granted                  | --                  | --                                       | --                  | --                                       |
| Exercised                | (85,000)            | 18.08                                    | (500,000)           | 4.10                                     |
| Cancelled/Forfeited      | --                  | --                                       | --                  | --                                       |
|                          | -----               |  | -----               |  |
| Outstanding at March 31  | 1,215,000           | 14.44                                    | 2,013,000           | 14.84                                    |
|                          | =====               |  | =====               |  |
| Exercisable at March 31  | 1,205,000           | 14.41                                    | 1,896,000           | 14.57                                    |
|                          | =====               |  | =====               |  |

Note L - Acquisition

On February 7, 2006, the Company acquired all of the equity interest of privately held Daniel M. Friedman and Associates, Inc. and D.M.F. International (collectively, "Daniel M. Friedman"). Founded in 1995, Daniel M. Friedman is a manufacturer and distributor of name brand fashion handbags and accessories. The acquisition was completed for consideration of \$18,500 including transaction costs subject to adjustment, including certain earn out provisions based on financial performance through 2010.

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STEVEN MADDEN, LTD. AND SUBSIDIARIES

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

### Note L - Acquisition (continued)

The Daniel M. Friedman acquisition was accounted for using the purchase method of accounting as required by SFAS Statement No. 141, "Business Combinations". Accordingly, the assets and liabilities of Daniel M. Friedman were adjusted to their fair values, and the excess of the purchase price over the fair value of the assets acquired, including identified intangible assets, was recorded as goodwill. The fair values assigned to tangible and intangible assets acquired and liabilities assumed are based on management's estimates and assumptions, as well as third-party independent valuations. The total preliminary purchase price has been allocated as follows:

|                               |    |         |
|-------------------------------|----|---------|
| Current assets                | \$ | 9,772   |
| Property, plant and equipment |    | 289     |
| Deposits                      |    | 62      |
| Intangible assets             |    | 8,400   |
| Goodwill                      |    | 5,172   |
| Liabilities assumed           |    | (5,195) |
|                               |    | -----   |
| Net assets acquired           | \$ | 18,500  |
|                               |    | =====   |

The purchase price and related allocation are preliminary and may be revised as a result of adjustments made to the purchase price pursuant to the earn out provisions or as additional information regarding assets and liabilities require.

The results of operations of Daniel M. Friedman have been included in the Company's Condensed Consolidated Statements of Operations from the date of the acquisition. The following pro forma information presents the results of the Company's operations as though the Daniel M. Friedman acquisition had been completed as of the first day of the quarters below:

|                            | Three Months Ended March 31, |           |
|----------------------------|------------------------------|-----------|
|                            | 2006                         | 2005      |
|                            | -----                        | -----     |
| Net sales                  | \$ 111,000                   | \$ 90,987 |
| Operating income           | \$ 18,634                    | \$ 2,448  |
| Net income                 | \$ 10,964                    | \$ 1,646  |
| Basic earnings per share   | \$ 0.79                      | \$ 0.12   |
| Diluted earnings per share | \$ 0.75                      | \$ 0.12   |

### Note M - Goodwill and Intangible Assets

The following is a summary of goodwill and the related accumulated amortization for the quarter ended March 31, 2006:

| Cost basis | Accumulated<br>Amortization | Net<br>carrying<br>amount |
|------------|-----------------------------|---------------------------|
| -----      | -----                       | -----                     |

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|                                   |    |       |    |       |    |       |
|-----------------------------------|----|-------|----|-------|----|-------|
| Balance at December 31, 2005      | \$ | 2,145 | \$ | 598   | \$ | 1,547 |
| Acquisition of Daniel M. Friedman |    | 5,172 |    | 0     |    | 5,172 |
|                                   |    | ----- |    | ----- |    | ----- |
| Balance at March 31, 2006         | \$ | 7,317 | \$ | 598   | \$ | 6,719 |
|                                   |    | ----- |    | ----- |    | ----- |

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STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited  
 March 31, 2006  
 (\$ in thousands except per share data)

Note M - Goodwill and Intangible Assets (continued)

The following table details intangible assets acquired on February 7, 2006 in the Daniel M. Friedman transaction as of March 31, 2006:

|                        | Cost basis | Accumulated Amortization | Net carrying amount |
|------------------------|------------|--------------------------|---------------------|
|                        | -----      | -----                    | -----               |
| Trade name             | \$ 200     | \$ 5                     | \$ 195              |
| Customer Relationships | 2,600      | 44                       | 2,556               |
| License Agreements     | 5,600      | 179                      | 5,421               |
|                        | -----      | -----                    | -----               |
|                        | \$ 8,400   | \$ 228                   | \$ 8,172            |
|                        | -----      | -----                    | -----               |

The estimated future amortization expense of purchased intangibles as of March 31, 2006 is as follows:

|                              |          |
|------------------------------|----------|
| 2006 (remaining nine months) | \$ 1,028 |
| 2007                         | 1,370    |
| 2008                         | 1,370    |
| 2009                         | 1,267    |
| 2010                         | 1,267    |
| Thereafter                   | 1,870    |
|                              | -----    |
|                              | \$ 8,172 |
|                              | =====    |

Note N - Comprehensive Income

Comprehensive income for the three-month periods ended March 31, 2006 and 2005, after considering other comprehensive income including unrealized gain (loss) on marketable securities of \$226 and (\$330), was \$11,086 and \$632, respectively.

NOTE O - COMMITMENTS, CONTINGENCIES AND OTHER

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### [1] Legal proceedings:

- (a) On July 28, 2005, adidas America, Inc., and adidas-Salomon AG (together, "adidas") filed a Demand for Arbitration (the "Demand") against Steve Madden, Ltd., and Steve Madden Retail, Inc. before the American Arbitration Association. In its Demand, adidas alleged that the parties had previously been engaged in a lawsuit over the Company's sale of sneakers that allegedly infringed adidas' "three stripe" mark. The parties settled that lawsuit by entering into a settlement agreement dated August 4, 2003 that prohibited the Company from selling shoes that contained adidas' "three-stripe" mark either with one additional stripe or with one less stripe. Adidas alleged in the Demand that the Company was selling three shoes (the Finnley, the Troyy, and the Soccet) that adidas contends violate the settlement agreement and infringe adidas' "three-stripe" mark. The parties are actively engaged in settlement discussions and have reached a tentative settlement. Settlement drafts have been exchanged but are still being negotiated. The settlement will not have a material affect on the Company's financial position.
- (b) On August 10, 2005, the U.S. Customs Department ("Customs") issued a report that asserts that certain commissions which the Company treated as buying agents commissions (which is non-dutiable), should be treated as "selling agents commissions" and hence is dutiable. In the report, Customs estimates that the Company had underpaid duties during the calendar years of 1998 through 2004 in the amount of \$1,051 plus interest and penalties. Based on management's estimation at this

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### STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited  
March 31, 2006  
(\$ in thousands except per share data)

### NOTE O - COMMITMENTS, CONTINGENCIES AND OTHER (CONTINUED)

point, a reserve of \$2,051 covering under-payments, interest and penalties, has been recorded as of the March 31, 2006 Condensed Consolidated Financial Statements. Such reserve may in the future be modified to reflect the status of this matter.

- (c) On or about January 23, 2006 the Company and Steven Madden, Jamieson Karson, Arvind Dharma and Amelia Newton Varela were named as defendants in a lawsuit filed by Jojeli, Inc. ("Jojeli") and Alan Rick Friedman in the United States District Court for the Southern District of New York. In their complaint, Jojeli and Mr. Friedman assert claims arising from the Company's decision to terminate Jojeli's services on or about November 28, 2005. Mr. Friedman, Jojeli's principal, served as a senior salesperson for the Company, and provided his services to the Company pursuant to an April 26, 2004 written agreement. In their complaint, Jojeli and Mr. Friedman allege eight claims against the Company and/or three of its executives and/or one of its managers, including breach of contract, violation of the New York Labor Law, tortious interference with contract, civil conspiracy, defamation, and prima facie tort. They seek damages on their various claims in

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differing amounts, ranging from \$500 to \$5,000 and they also seek a declaration that they are not bound by the restrictive covenant in the parties' contract. On or about March 1, 2006, the individual defendants and the Company moved to dismiss the tort claims contained in the complaint and to strike Mr. Friedman's claim for punitive damages in connection with his contract claims. More specifically, the defendants moved to dismiss the claims alleging defamation, interference with contract, prima facie tort and civil conspiracy. If the motion is granted in its entirety, the individual defendants would be dismissed from the suit and Mr. Friedman's remaining claims would consist of breach of contract and alleged violations of the New York Labor Law. On or about April 13, 2006, Mr. Friedman filed an amended complaint in the action. In his amended complaint, Mr. Friedman (i) dropped his defamation claim against the Company's Executive Vice President of Wholesale Sales, Amelia Newton Varela, (ii) dropped all claim(s) against the Company's Chief Financial Officer, Arvind Dharia, and (iii) supplemented certain allegations concerning the remaining defendants in an effort to strengthen or preserve his remaining tort claims. On April 13th, 2006 Mr. Friedman also filed his opposition to the motion to dismiss previously filed by the Company and the individual defendants. The Company and the individual defendants responded to Mr. Friedman's opposition to the motion to dismiss on May 3, 2006 and Mr. Friedman has until May 11, 2006 to respond. Based on management's estimation at this point, a reserve of \$364 has been recorded as of the March 31, 2006 Condensed Consolidated Financial Statements. Such reserve may in the future be modified to reflect the status of this matter.

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

### [2] Stock Split

On April 27, 2006, the Board of Directors declared a 3-for-2 stock split of its outstanding shares of common stock, to be effected in the form of a stock dividend on the Company's issued and outstanding common stock. Stockholders of record at the close of business on May 11, 2006 will receive one additional share of Steven Madden Ltd. common stock for every two shares of common stock owned on this date. The additional shares are expected to be distributed on or about May 25, 2006. Stockholders will receive cash in lieu of any fractional shares of common stock they otherwise would have received in connection with the dividend.

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STEVEN MADDEN, LTD. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements - Unaudited  
March 31, 2006  
(\$ in thousands except per share data)

Note P - Operating Segment Information

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The Company's reportable segments are primarily based on methods used to distribute its products. The wholesale segment, through sales to department and specialty stores, and the retail segment, through the operation of retail stores and the website, derive revenue from sales of branded women's, men's, girl's and children's footwear and accessories. In addition, the wholesale segment has a licensing program that extends the Steve Madden and Stevies brands to accessories and ready-to-wear apparel. The private label segment represents activities of a subsidiary which earns commissions for serving as a buying agent to mass-market merchandisers, shoe chains and other off-price retailers with respect to their purchase of private label shoes.

|                                      | Wholesale | Retail    | Private label | Consolidat |
|--------------------------------------|-----------|-----------|---------------|------------|
|                                      | -----     | -----     | -----         | -----      |
| Quarter ended March 31, 2006:        |           |           |               |            |
| Net sales to external customers      | \$ 82,982 | \$ 25,333 |               | \$ 108,3   |
| Gross profit                         | 34,125    | 12,158    |               | 46,2       |
| Commissions and licensing fees - net | 805       |           | \$ 2,957      | 3,7        |
| Income (loss) from operations        | 16,629    | (1,131)   | 2,957         | 18,4       |
| Segment assets                       | 170,478   | 41,736    | 17,281        | 229,4      |
| Quarter ended March 31, 2005:        |           |           |               |            |
| Net sales to external customers      | \$ 56,861 | \$ 26,475 |               | \$ 83,3    |
| Gross profit                         | 15,806    | 11,932    |               | 27,7       |
| Commissions and licensing fees - net | 580       |           | \$ 645        | 1,2        |
| Income (loss) from operations        | 1,046     | (470)     | 645           | 1,2        |
| Segment assets                       | 136,881   | 38,986    | 9,767         | 185,6      |

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

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes thereto appearing elsewhere in this quarterly report on Form 10-Q.

Statements in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this quarterly report on Form 10-Q as well as statements made in press releases and oral statements that may be made by the Company or by its officers, directors or employees acting on the Company's behalf that are not statements of historical or current fact constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other unknown factors that could cause the actual results of the Company to be materially different from historical results or from any future results expressed or implied by such forward-looking statements. In addition to statements which explicitly describe such risks and uncertainties, readers are urged to consider statements labeled with the terms "believes", "belief", "expects", "intends", "anticipates", "projects" or "plans" to be uncertain, forward-looking statements. The forward-looking statements contained herein are also subject generally to other risks and uncertainties that are described from time to time in the Company's reports and registration statements filed with the Securities and Exchange Commission.

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### Overview:

(\$ in thousands, except retail sales data per square foot and earnings per share data)

The momentum established by the Company during the second half of 2005 continued in the first quarter of 2006. Net sales increased 30% to \$108,315 in the quarter ended March 31, 2006 from \$83,336 in the comparable period of 2005, while net commission and licensing fee income increased 207% to \$3,762 from \$1,225 during the same period. Net income increased to \$10,860 in the first quarter of 2006 compared to \$962 for the same period of 2005. The Company's diluted earnings per share increased to \$0.74 per share for the quarter ended March 31, 2006 compared to \$0.07 per share in the comparable period of 2005.

The sales growth was driven by a very strong performance from the Company's existing brands in addition to the contribution of the recently acquired Daniel M. Friedman. It is also the result of the Company's continued efforts to diversify its brand portfolio and expand its product offerings. SM New York, which was introduced in the fourth quarter of last year, performed better than expected. In addition, the Company introduced the Rule product line in this quarter, which also added to the Company's sales growth.

The Company's new inventory controls and other operating initiatives implemented last year continued to pay dividends. Gross margin for the quarter increased significantly to 43% from 33% in the comparable period last year.

In the Retail Division, first quarter of 2006 sales decreased 4% to \$25,333 from \$26,475 in the same period last year. Same store sales (sales in stores that were in operation throughout the first quarter of 2006 and 2005) decreased 8%. The sales decrease was due primarily to planned declines in the accessories and men's categories as the Company repositions its offerings in those areas, as well as a reduction in promotional sales. Store sales productivity remained high with sales per square foot of stores opened for twelve months of \$741.

The Company's annualized inventory turnover increased to 8 times in quarter ended March 31, 2006 compared to 7 times in the comparable period of 2005, reflecting the inventory controls mentioned above. The Company's accounts receivable average collection days (excluding the newly acquired Daniel M. Friedman division) improved to 56 days in the first quarter of 2006 compared to 63 days in the comparable period of 2005. As of March 31, 2006, the Company had \$79,029 in cash, cash equivalents and marketable securities, no short or long-term debt, and total stockholders equity of \$189,941. Working capital increased to \$110,840 as of March 31, 2006, compared to \$101,632 on March 31, 2005.

The Company continued to prove its commitment to return capital to the shareholders and its confidence in the Company's future by repurchasing 147,000 shares of the Company's common stock for approximately \$4,800.

On April 27, 2006, the Board of Directors declared a 3-for-2 stock split of its outstanding shares of common stock, to be effected in the form of a stock dividend on the Company's issued and outstanding common stock. Stockholders of record at the close of business on May 11, 2006 will receive one additional share of Steven Madden Ltd. common stock for every two shares of common stock

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owned on this date. The additional shares are expected to be distributed on or about May 25, 2006. Stockholders will receive cash in lieu of any fractional share of common stock they otherwise would have received in connection with the dividend.

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The following tables set forth information on operations for the periods indicated:

Selected Financial Information  
Three Months Ended  
March 31  
(\$ in thousands)

|  | 2006       |      | 2005      |      |
|--|------------|------|-----------|------|
| <b>CONSOLIDATED:</b><br>-----            |            |      |           |      |
| Net sales                                | \$ 108,315 | 100% | \$ 83,336 | 100% |
| Cost of sales                            | 62,032     | 57   | 55,984    | 67   |
| Gross profit                             | 46,283     | 43   | 27,352    | 33   |
| Other operating income - net of expenses | 3,762      | 3    | 1,225     | 1    |
| Operating expenses                       | 31,590     | 29   | 27,356    | 33   |
| Income from operations                   | 18,455     | 17   | 1,221     | 1    |
| Interest and other income, net           | 271        | 0    | 438       | 1    |
| Income before income taxes               | 18,726     | 17   | 1,659     | 2    |
| Net income                               | 10,860     | 10   | 962       | 1    |

By Segment:

**WHOLESALE DIVISION:**  
-----

|                        |           |      |           |      |
|------------------------|-----------|------|-----------|------|
| Net sales              | \$ 82,982 | 100% | \$ 56,861 | 100% |
| Cost of sales          | 48,857    | 59   | 41,441    | 73   |
| Gross profit           | 34,125    | 41   | 15,420    | 27   |
| Other operating income | 805       | 1    | 580       | 1    |
| Operating expenses     | 18,301    | 22   | 14,954    | 26   |
| Income from operations | 16,629    | 20   | 1,046     | 2    |

**RETAIL DIVISION:**  
-----

**Steven Madden Retail Inc.:**  
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|                      |           |      |           |      |
|----------------------|-----------|------|-----------|------|
| Net sales            | \$ 25,333 | 100% | \$ 26,475 | 100% |
| Cost of sales        | 13,175    | 52   | 14,543    | 55   |
| Gross profit         | 12,158    | 48   | 11,932    | 45   |
| Operating expenses   | 13,289    | 52   | 12,402    | 47   |
| Loss from operations | (1,131)   | (4)  | (470)     | (2)  |
| Number of stores     | 99        |      | 92        |      |

**ADESSO MADDEN INC.:**  
-----

(FIRST COST)

|  |          |      |        |      |
|--|----------|------|--------|------|
| Other commission income- net of expenses | \$ 2,957 | 100% | \$ 645 | 100% |
|--|----------|------|--------|------|

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RESULTS OF OPERATIONS  
(\$ in thousands)

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Three Months Ended March 31, 2006 vs. Three Months Ended March 31, 2005

Consolidated:

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Total net sales for the three-month period ended March 31, 2006 increased by 30% to \$108,315 from \$83,336 for the comparable period of 2005. This increase resulted from higher sales contributed by the Wholesale Division including the February 7, 2006 acquisition of Daniel M. Friedman, which was partially offset by a sales decline in the Retail Division.

Gross profit as a percentage of sales increased to 43% in 2006 from 33% in 2005. Gross profit as a percentage of sales in the Wholesale Division increased to 41% in 2006 from 27% in 2005, while the gross profit as a percentage of sales in the Retail Division increased to 48% in 2006 from 45% in 2005.

Operating expenses increased to \$31,590 in 2006 from \$27,356 in 2005. The increase in dollars is primarily due to an increase in direct selling expenses reflective of the 30% growth in sales and the incremental payroll and occupancy costs associated with the operation of an additional seven retail stores (net) and the incremental costs associated with the new brands, SMNY and Rule and recently acquired Daniel M. Friedman. As a percentage of sales, operating expenses decreased to 29% in 2006 from 33% in 2005, reflecting the Company's ability to control costs and leverage its expense structure against the increase in sales.

Income from operations was \$18,455 in 2006 compared to \$1,221 in 2005. Net income was \$10,860 in 2006 compared to \$962 in 2005. This increase in income was primarily due to the increase in sales, the higher gross profit and the substantial increase in commission income.

Wholesale Division:

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Sales from the Wholesale Division accounted for \$82,982 or 77%, and \$56,861 or 68%, of total sales in 2006 and 2005, respectively. This increase resulted from the incremental sales of the recently acquired Daniel M. Friedman and higher sales from Candie's, Madden Womens and Madden Mens as well as the contribution of the new brands, SMNY and Rule. Gross profit as a percentage of sales in the Wholesale Division increased to 41% in 2006 from 27% in 2005, primarily due to a significant decrease in off-price sales and improved efficiencies in inventory management resulting in lower inventory markdowns and allowances. Operating expenses increased to \$18,301 in 2006 from \$14,954 in 2005. This increase is primarily due to an increase in direct selling expenses reflective of the 46% growth in sales and the incremental costs associated with the launch of the new brands SMNY and Rule and Daniel M. Friedman. As a percentage of sales, operating expenses decreased to 22% in 2006 from 26% in 2005, reflecting the Company's ability to control costs and leverage the Company's expense structure against top line growth. Income from operations for the Wholesale Division increased to \$16,629 in 2006 compared to \$1,046 in 2005.

Retail Division:

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Sales from the Retail Division accounted for \$25,333 or 23% and \$26,475 or 32% of total sales in 2006 and 2005, respectively. As of March 31, 2006, there were 99 retail stores compared to 92 retail stores as of March 31, 2005. Comparable store sales (sales of those stores that were open for the entire first quarters of 2006 and 2005) for the three-month period ended March 31, 2006 decreased 8% over the same period of 2005. This decrease was due primarily to planned declines in the accessories and men's categories as management repositions the

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Company's offerings in those areas. Gross profit as a percentage of sales increased to 48% in 2006 from 45% in 2005, primarily due to a significant decrease in inventory markdowns and other promotional activities. Operating expenses for the Retail Division were \$13,289 in 2006 and \$12,402 in 2005. This increase was primarily due to increased payroll and payroll related expenses and higher occupancy expenses associated with the operation of seven additional stores in the current period. Loss from operations for the Retail Division was \$1,131 in 2006 compared to \$470 in 2005.

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Adesso-Madden Division:  
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Adesso-Madden, Inc. generated net commission income of \$2,957 in 2006, compared to \$645 in 2005. The increase was the result of growth in the private label business and in addition, the Company has leveraged the strength of its Steve Madden brands and product designs resulting in a partial recovery of its design, product and development costs from its suppliers.

### LIQUIDITY AND CAPITAL RESOURCES

(\$ in thousands)

The Company had working capital of \$110,840 at March 31, 2006 compared to \$114,066 at December 31, 2005. The decrease was primarily due to the Company's acquisition of Daniel M. Friedman for \$15,148 on February 7, 2006 and to the repurchase of 147,000 shares of the Company's common stock at a total cost of \$4,807.

Under the terms of a factoring agreement with GMAC, the Company is eligible to draw down 80% of its invoiced receivables at an interest rate of two and one-half percent (2.5%) over the 30 day LIBOR. The agreement, which has no specific expiration date and can be terminated by either party with 60 days written notice after June 30, 2007, provides the Company with a \$25 million credit facility with a \$15 million sub-limit on direct borrowings. GMAC maintains a lien on all of the Company's receivables and assumes the credit risk for all assigned accounts approved by them. As of March 31, 2006, the Company had not used any portion of the credit line.

As of March 31, 2006, the Company had invested \$54,908 in marketable securities consisting of corporate bonds, U.S. Treasury notes, government asset-backed securities, certificates of deposits and equities.

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

### OPERATING ACTIVITIES

(\$ in thousands)

During the three-month period ended March 31, 2006, net cash used in operating activities was \$9,954. Sources of cash were provided primarily by the net income of \$10,860. The primary uses of cash were an increase in factored receivables of \$23,907 caused by a substantial increase in sales in the first quarter of 2006, as well as an increase in non-factored receivables of \$1,007 and an increase in inventories of \$2,284.

### CONTRACTUAL OBLIGATIONS

The Company's contractual obligations as of March 31, 2006 were as follows:

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| Contractual Obligations   | Total             | Payment due by period (in thousands) |                  |                  | 2011 a<br>afte |
|---|-------------------|--------------------------------------|------------------|------------------|----------------|
|   |                   | Remainder of<br>2006                 | 2007-2008        | 2009-2010        |                |
| Operating lease obligations   | \$ 88,877         | \$ 9,550                             | \$ 25,802        | \$ 21,182        | \$ 3           |
| Purchase obligations  | 63,097            | 63,097                               | 0                | 0                |                |
| Other long-term liabilities<br>(future minimum<br>royalty payments) | 2,934             | 2,299                                | 635              | 0                |                |
| <b>Total</b>  | <b>\$ 154,908</b> | <b>\$ 74,946</b>                     | <b>\$ 26,437</b> | <b>\$ 21,182</b> | <b>\$ 3</b>    |

At March 31, 2006, the Company had un-negotiated open letters of credit for the purchase of imported merchandise of approximately \$2,842.

The Company has an employment agreement with Steven Madden, its Creative and Design Chief, which provides for an annual base salary of \$600 subject to certain specified adjustments, through June 30, 2015. The agreement also

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provides for annual bonuses based on EBITDA, on revenue of any new business, and royalty income over \$2 million, an annual option grant at exercise prices equal to the market price on the date of grant and a non-accountable expense allowance.

On February 7, 2006, the Company acquired all of the equity interest of privately held Daniel M. Friedman and Associates, Inc. and D.M.F. International (collectively, "Daniel M. Friedman"). The acquisition was completed for consideration of \$18,500 including transaction costs subject to adjustment, including certain earn out provisions, based on financial performance through 2010.

The Company has employment agreements with certain executives, which provide for the payment of compensation aggregating approximately \$2,149 in 2006, \$1,643 in 2007, \$1,192 in 2008 and \$480 in 2009. In addition, such employment agreements provide for incentive compensation based on various performance criteria as well as other benefits. The Chief Operating Officer and Executive V.P. of Wholesale Sales of the Company are entitled to deferred compensation calculated as a percentage of their base salary.

Significant portions of the Company's products are produced at overseas locations, the majority of which are located in China as well as Brazil, Italy and Spain. The Company has not entered into any long-term manufacturing or supply contracts with any of these foreign companies. The Company believes that a sufficient number of alternative sources exist outside of the United States for the manufacture of its products. In addition, the Company currently makes approximately 97% of its purchases in U.S. dollars.

INVESTING ACTIVITIES  
(\$ in thousands)

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During the three-month period ended March 31, 2006, the Company invested \$73 in marketable securities and received \$11,232 from the maturities and sales of securities. Also, the Company recently invested \$15,148 in order to acquire Daniel M. Friedman. Additionally, the Company made capital expenditures of \$1,508, principally for leasehold improvements for one new store and remodeling of three existing stores, as well as for additional office space and upgrades to its computer systems.

### FINANCING ACTIVITIES

(\$ in thousands)

During the three-month period ended March 31, 2006, the Company repurchased 147,000 shares of the Company's common stock at a total cost of \$4,807. The Company received \$1,537 in connection with the exercise of stock options.

### INFLATION

The Company does not believe that the relatively low rates of inflation experienced over the last few years in the United States, where it primarily competes, have had a significant effect on sales, expenses or profitability.

### CRITICAL ACCOUNTING POLICIES AND THE USE OF ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon the Company's unaudited condensed consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, sales and expenses, and related disclosure of contingent assets and liabilities. Estimates by their nature are based on judgments and available information. Estimates are made based upon historical factors, current circumstances and the experience and judgment of management. Assumptions and estimates are evaluated on an ongoing basis and the Company may employ outside experts to assist in evaluations. Therefore, actual results could materially differ from those estimates under different assumptions and conditions. Management believes the following critical accounting estimates are more significantly affected by judgments and estimates used in the preparation of the Company's condensed consolidated financial statements: accounts receivable and inventory reserves, valuation of intangible assets, and litigation reserves.

Allowances for bad debts, returns and customer chargebacks. The Company provides reserves against its trade accounts receivables for future customer chargebacks, co-op advertising allowances, discounts, returns and other miscellaneous

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deductions that relate to the current period. The reserve against the Company's non-factored trade receivables also includes estimated losses that may result from customers' inability to pay. The amount of the reserve for bad debts, returns, discounts and compliance chargebacks are determined by analyzing aged receivables, current economic conditions, the prevailing retail environment and historical dilution levels for customers. As a result of a reevaluation of the retail environment, the Company has revised its method for evaluating its allowance for customer markdowns and advertising chargebacks in the fourth quarter of 2005. In the past, the Company would look at historical dilution levels for customers to determine the allowance amount. Under the new methodology, the Company evaluates anticipated chargebacks by reviewing several performance indicators for its major customers. These performance indicators (which include inventory levels at the retail floors, sell through rates and

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gross margin levels) are analyzed by key account executives to estimate the amount of the anticipated customer allowance. Failure to correctly estimate the amount of the reserve could materially impact the Company's results of operation and financial position.

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

Valuation of intangible assets. SFAS No. 142, "Goodwill and Other Intangible Assets, which was adopted by the Company on January 1, 2002, requires that goodwill and intangible assets with indefinite lives no longer be amortized, but rather be tested for impairment at least annually. This pronouncement also requires that intangible assets with finite lives be amortized over their respective lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144 "Accounting for Impairment or Disposal of Long-lived Assets". In accordance with SFAS No. 144, long-lived assets, such as property, equipment, leasehold improvements and goodwill subject to amortization, are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

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

Cost of sales. All costs incurred to bring finished products to the Company's distribution center are included in the cost of sales line item on the Consolidated Statement of Operations. These include purchase commissions, letter of credit fees, brokerage fees, material and labor and related items, sample expenses, custom duty, inbound freight, royalty payments, labels and product packaging. All warehouse and distribution costs are included in the operating expenses line item of the Company's Consolidated Statement of Operations. The Company classifies all shipping costs to customers as operating expenses. The Company's gross margins may not be comparable to other companies in the industry because some companies may include warehouse and distribution as a component of cost of sales, while other companies report on the same basis as the Company and include them in operating expenses.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company does not engage in the trading of market risk sensitive instruments in the normal course of business. Financing arrangements for the Company are subject to variable interest rates primarily based on LIBOR. An analysis of the

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Company's credit agreement with GMAC can be found in Liquidity and Capital Resources section under Item 2 of this document. As of March 31, 2006 and 2005, there were no direct borrowings outstanding under the credit agreement.

As of March 31, 2006, the Company had investments in marketable securities valued at \$54,908, which consist primarily of corporate bonds, U.S. treasury notes, certificates of deposit and government asset-backed securities that have various maturities through December 2009, as well as marketable equity securities. These investments are subject to interest rate risk and will decrease in value if market interest rates increase. The Company currently has the ability to hold these investments until maturity. Should there be a significant increase in interest rates, the value of these investments would be negatively affected unless they were held to maturity. In addition, any further decline in interest rates would reduce the Company's interest income.

### ITEM 4. CONTROLS AND PROCEDURES

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of its disclosure controls and procedures as of the end of the fiscal quarter covered by this quarterly report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) were effective as of the end of the fiscal quarter covered by this quarterly report. As required by Rule 13a-15(d) under the Exchange Act, the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the Company's internal controls over financial reporting to determine whether any changes occurred during the quarter covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during the quarter covered by this report.

## Part II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

Certain legal proceedings in which the Company is involved are discussed in Note K and Part I, Item 3 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. The following discussion is limited to recent developments concerning certain of the Company's legal proceedings and should be read in conjunction with the Company's earlier SEC Reports. Unless otherwise indicated, all proceedings discussed in those earlier Reports remain outstanding.

On July 28, 2005, adidas America, Inc., and adidas-Salomon AG (together, "adidas") filed a Demand for Arbitration (the "Demand") against Steve Madden, Ltd., and Steve Madden Retail, Inc. before the American Arbitration Association. In its Demand, adidas alleged that the parties had previously been engaged in a

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lawsuit over the Company's sale of sneakers that allegedly infringed adidas' "three stripe" mark. The parties settled that lawsuit by entering into a settlement agreement dated August 4, 2003 that prohibited the Company from selling shoes that contained adidas' "three-stripe" mark either with one additional stripe or with one less stripe. Adidas alleged in the Demand that the Company was selling three shoes (the Finnley, the Troyy, and the Soccet) that adidas contends violate the settlement agreement and infringe adidas' "three-stripe" mark. The parties are actively engaged in settlement discussions and have reached a tentative settlement. Settlement drafts have been exchanged but are still being negotiated. The settlement will not have a material affect on the Company's financial position.

On August 10, 2005, the U.S. Customs Department ("Customs") issued a report that asserts that certain commissions which the Company treated as buying agents commissions (which is non-dutiable), should be treated as "selling agents commissions" and hence is dutiable. In the report, Customs estimates that the Company had underpaid duties during the calendar years of 1998 through 2004 in the amount of \$1,051 plus interest and penalties. Based on management's estimation at this point, a reserve of \$2,051 covering under-payments, interest and penalties, has been recorded as of the March 31, 2006 Condensed Consolidated Financial Statements. Such reserve may in the future be modified to reflect the status of this matter.

On or about January 23, 2006 the Company and Steven Madden, Jamieson Karson, Arvind Dharia and Amelia Newton Varela were named as defendants in a lawsuit filed by Jojeli, Inc. ("Jojeli") and Alan Rick Friedman in the United States District Court for the Southern District of New York. In their complaint, Jojeli

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and Mr. Friedman assert claims arising from the Company's decision to terminate Jojeli's services on or about November 28, 2005. Mr. Friedman, Jojeli's principal, served as a senior salesperson for the Company, and provided his services to the Company pursuant to an April 26, 2004 written agreement. In their complaint, Jojeli and Mr. Friedman allege eight claims against the Company and/or three of its executives and/or one of its managers, including breach of contract, violation of the New York Labor Law, tortuous interference with contract, civil conspiracy, defamation, and prima facie tort. They seek damages on their various claims in differing amounts, ranging from \$500 to \$5,000 and they also seek a declaration that they are not bound by the restrictive covenant in the parties' contract. On or about March 1, 2006, the individual defendants and the Company moved to dismiss the tort claims contained in the complaint and to strike Mr. Friedman's claim for punitive damages in connection with his contract claims. More specifically, the defendants moved to dismiss the claims alleging defamation, interference with contract, prima facie tort and civil conspiracy. If the motion is granted in its entirety, the individual defendants would be dismissed from the suit and Mr. Friedman's remaining claims would consist of breach of contract and alleged violations of the New York Labor Law. On or about April 13, 2006, Mr. Friedman filed an amended complaint in the action. In his amended complaint, Mr. Friedman (i) dropped his defamation claim against the Company's Executive Vice President of Wholesale Sales, Amelia Newton Varela, (ii) dropped all claim(s) against the Company's Chief Financial Officer, Arvind Dharia, and (iii) supplemented certain allegations concerning the remaining defendants in an effort to strengthen or preserve his remaining tort claims. On April 13th, 2006 Mr. Friedman also filed his opposition to the motion to dismiss previously filed by the Company and the individual defendants. The Company and the individual defendants responded to Mr. Friedman's opposition to the motion to dismiss on May 3, 2006 and Mr. Friedman has until May 11, 2006 to respond. Based on management's estimation at this point, a reserve of \$364 has been recorded as of the March 31, 2006 Condensed Consolidated Financial Statements. Such reserve may in the future be modified to reflect the status of

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this matter.

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

### ITEM 1A RISK FACTORS

The risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 have not materially changed.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS:

The following table provides information as of March 31, 2006 with respect to the shares of common stock repurchased by the Company during the first quarter of fiscal 2006:

| Period              | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs (1) | Maximum Dollar Amount<br>of Shares that May Yet Be<br>Purchased Under the Plans<br>or Programs (1) |
|---------------------|---|------------------------------------|--|--|
| 1/1/06 -<br>1/31/06 | 0   | \$ 0                               | 0  | \$23,751,178   |
| 2/1/06 -<br>2/28/06 | 90,500                                    | \$32.02                            | 90,500   | \$20,853,587   |
| 3/1/06 -<br>3/31/06 | 56,900                                    | \$33.56                            | 56,900   | \$18,943,810   |
| Total               | 147,400                                   | \$32.61                            | 147,400  | \$18,943,810   |

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- (1) Pursuant to an agreement reached on February 2, 2005, with a then 8% shareholder, the Company agreed to commit \$25 million during the twelve months ended January 31, 2006 and \$10 million during the twelve months ended January 31, 2007 to a combination of share repurchases and/or dividends, such programs to be implemented at such time and such manner as the board of directors shall determine in its sole discretion.

### ITEM 6. EXHIBITS

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- 10.1 Employment Agreement of Jamieson Karson (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on January 6, 2006).
- 10.2 Amendment No. 3 to Employment Agreement of Arvind Dharia (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on February 3, 2006).
- 10.3 Stock Purchase Agreement, dated as of February 7, 2006, by and between the Company and Daniel M. Friedman (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on February 13, 2006).
- 10.4 Earn-Out Agreement, dated as of February 7, 2006, by and among the Company, Daniel M. Friedman, Daniel M. Friedman & Associates, Inc. and DMF International, Ltd. (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed with the Commission on February 13, 2006).
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

DATE: May 10, 2006

STEVEN MADDEN, LTD.

/s/ JAMIESON A. KARSON

-----  
Jamieson A. Karson  
Chairman and Chief Executive Officer

/s/ ARVIND DHARIA

-----  
Arvind Dharia  
Chief Financial Officer

| Exhibit No<br>----- | Description<br>-----  |
|---------------------|---|
| 10.1                | Employment Agreement of Jamieson Karson (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the Commission on January 6, 2006).   |
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