

UNITED STATES
SECURITIES AND 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 April 30, 2006

OR

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

Commission file number 1-14229

QUIKSILVER, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

33-0199426

(I.R.S. Employer
Identification Number)

**15202 Graham Street
Huntington Beach, California
92649**

(Address of principal executive offices)
(Zip Code)

(714) 889-2200

(Registrant's telephone number, including area code)

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. (Check one):

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**

The number of shares outstanding of Registrant's Common Stock,
par value \$0.01 per share, at
June 5, 2006 was 122,294,089

QUIKSILVER, INC.

FORM 10-Q INDEX

<u>PART I - FINANCIAL INFORMATION</u>	<u>Page No.</u>
Item 1. Financial Statements (Unaudited):	
Condensed Consolidated Balance Sheets April 30, 2006 and October 31, 2005	2
Condensed Consolidated Statements of Income Three Months Ended April 30, 2006 and 2005	3
Condensed Consolidated Statements of Income Six Months Ended April 30, 2006 and 2005	4
Condensed Consolidated Statements of Comprehensive Income Six Months Ended April 30, 2006 and 2005	4
Condensed Consolidated Statements of Cash Flows Six Months Ended April 30, 2006 and 2005	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	
Results of Operations	23
Three Months Ended April 30, 2006 Compared to Three Months Ended April 30, 2005	24
Six Months Ended April 30, 2006 Compared to Six Months Ended April 30, 2005	26
Financial Position, Capital Resources and Liquidity	27
Critical Accounting Policies	29
New Accounting Pronouncements	31
Forward-Looking Statements	32
Item 3. Quantitative and Qualitative Disclosures about Market Risk.....	33
Item 4. Controls and Procedures	33
<u>Part II - OTHER INFORMATION</u>	
Item 4. Submission of Matters to a Vote of Security Holders	34
Item 6. Exhibits.....	35
<u>SIGNATURES</u>	36

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

QUIKSILVER, INC.

**CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)**

<i>In thousands, except share amounts</i>	April 30, <u>2006</u>	October 31, <u>2005</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 96,818	\$ 75,598
Trade accounts receivable, less allowances of \$19,875 (2006) and \$10,727 (2005)	482,978	599,486
Other receivables	26,633	27,414
Inventories	402,033	386,396
Deferred income taxes	44,220	41,646
Prepaid expenses and other current assets	<u>26,017</u>	<u>21,819</u>
Total current assets	1,078,699	1,152,359
Fixed assets, less accumulated depreciation and amortization of \$155,314 (2006) and \$121,453 (2005)	266,096	241,979
Intangible assets, net	247,482	247,702
Goodwill	475,730	449,377
Other assets	45,464	43,955
Assets held for sale	<u>18,944</u>	<u>23,229</u>
Total assets	<u>\$ 2,132,415</u>	<u>\$ 2,158,601</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Lines of credit	\$ 205,471	\$ 220,113
Accounts payable	197,193	212,407
Accrued liabilities	147,556	182,973
Current portion of long-term debt	16,267	50,833
Income taxes payable	<u>—</u>	<u>27,176</u>
Total current liabilities	566,487	693,502
Long-term debt, net of current portion	684,800	640,348
Deferred income taxes	<u>74,340</u>	<u>81,628</u>
Total liabilities	<u>1,325,627</u>	<u>1,415,478</u>
Minority interest	10,353	10,241
Stockholders' equity:		
Preferred stock, \$.01 par value, authorized shares - 5,000,000; issued and outstanding shares - none	—	—
Common stock, \$.01 par value, authorized shares - 185,000,000; issued shares – 125,158,289 (2006) and 124,093,392 (2005)	1,252	1,241
Additional paid-in capital	261,734	242,284
Treasury stock, 2,885,200 shares	(6,778)	(6,778)
Retained earnings	488,375	466,043
Accumulated other comprehensive income	<u>51,852</u>	<u>30,092</u>
Total stockholders' equity	<u>796,435</u>	<u>732,882</u>
Total liabilities and stockholders' equity	<u>\$ 2,132,415</u>	<u>\$ 2,158,601</u>

See notes to condensed consolidated financial statements.

QUIKSILVER, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

<i>In thousands, except per share amounts</i>	Three months ended April 30,	
	<u>2006</u>	<u>2005</u>
Revenues, net	\$ 516,928	\$ 426,853
Cost of goods sold.....	<u>282,438</u>	<u>233,488</u>
Gross profit	234,490	193,365
Selling, general and administrative expense.....	<u>215,838</u>	<u>139,314</u>
Operating income.....	18,652	54,051
Interest expense	11,949	3,269
Foreign currency gain.....	(496)	(288)
Minority interest and other expense	<u>1,637</u>	<u>(61)</u>
Income before provision for income taxes	5,562	51,131
Provision for income taxes	<u>1,833</u>	<u>16,464</u>
Net income	<u>\$ 3,729</u>	<u>\$ 34,667</u>
Net income per share	<u>\$ 0.03</u>	<u>\$ 0.29</u>
Net income per share, assuming dilution	<u>\$ 0.03</u>	<u>\$ 0.28</u>
Weighted average common shares outstanding.....	<u>122,018</u>	<u>118,169</u>
Weighted average common shares outstanding, assuming dilution.....	<u>127,790</u>	<u>123,791</u>

See notes to condensed consolidated financial statements.

QUIKSILVER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

<i>In thousands, except per share amounts</i>	<u>Six months ended April 30,</u>	
	<u>2006</u>	<u>2005</u>
Revenues, net	\$ 1,058,070	\$ 769,713
Cost of goods sold.....	575,019	423,442
Gross profit	483,051	346,271
Selling, general and administrative expense.....	427,143	268,797
Operating income.....	55,908	77,474
Interest expense	24,540	5,058
Foreign currency (gain) loss.....	(993)	175
Minority interest and other expense	411	145
Income before provision for income taxes	31,950	72,096
Provision for income taxes	9,618	23,215
Net income	<u>\$ 22,332</u>	<u>\$ 48,881</u>
Net income per share	<u>\$ 0.18</u>	<u>\$ 0.41</u>
Net income per share, assuming dilution	<u>\$ 0.18</u>	<u>\$ 0.40</u>
Weighted average common shares outstanding.....	<u>121,721</u>	<u>117,877</u>
Weighted average common shares outstanding, assuming dilution.....	<u>127,479</u>	<u>123,448</u>

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

<i>In thousands</i>	<u>Six months ended April 30,</u>	
	<u>2006</u>	<u>2005</u>
Net income	\$ 22,332	\$ 48,881
Other comprehensive income (loss):		
Foreign currency translation adjustment	26,329	7,340
Net unrealized (loss) income on derivative instruments, net of tax of \$(2,255) (2006), \$1,516 (2005)	(4,569)	2,375
Comprehensive income.....	<u>\$ 44,092</u>	<u>\$ 58,596</u>

See notes to condensed consolidated financial statements.

QUIKSILVER, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

<i>In thousands</i>	Six months ended April 30,	
	2006	2005
Cash flows from operating activities:		
Net income.....	\$ 22,332	\$ 48,881
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	31,352	16,626
Stock based compensation.....	11,324	—
Provision for doubtful accounts.....	3,210	3,624
(Gain) loss on sale of fixed assets.....	(19)	283
Foreign currency (gain) loss.....	(256)	465
Interest accretion.....	—	998
Minority interest and equity in earnings.....	911	—
Changes in operating assets and liabilities:		
Trade accounts receivable.....	128,592	(63,018)
Other receivables.....	1,003	638
Inventories.....	(2,044)	3,031
Prepaid expenses and other current assets.....	(2,561)	(5,627)
Other assets.....	(3,377)	(3,084)
Accounts payable.....	(20,494)	4,719
Accrued liabilities.....	(34,701)	(9,364)
Income taxes payable.....	(21,129)	5,761
Net cash provided by operating activities.....	114,143	3,933
Cash flows from investing activities:		
Capital expenditures.....	(42,736)	(24,732)
Deposit on planned acquisition.....	—	(59,588)
Business acquisitions, net of cash acquired.....	(28,447)	(21,389)
Net cash used in investing activities.....	(71,183)	(105,709)
Cash flows from financing activities:		
Borrowings on lines of credit.....	137,932	35,172
Payments on lines of credit.....	(174,759)	(21,536)
Borrowings on long-term debt.....	116,014	104,149
Payments on long-term debt.....	(107,367)	(7,036)
Proceeds from stock option exercises.....	4,666	3,494
Net cash (used in) provided by financing activities.....	(23,514)	114,243
Effect of exchange rate changes on cash.....	1,774	345
Net increase in cash and cash equivalents.....	21,220	12,812
Cash and cash equivalents, beginning of period.....	75,598	55,197
Cash and cash equivalents, end of period.....	\$ 96,818	\$ 68,009
Supplementary cash flow information:		
Cash paid during the period for:		
Interest.....	\$ 23,712	\$ 4,482
Income taxes.....	\$ 32,859	\$ 16,443

See notes to condensed consolidated financial statements.

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. *Basis of Presentation*

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statement presentation.

Quiksilver, Inc. (the "Company"), in its opinion, has included all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the results of operations for the three and six months ended April 30, 2006 and 2005. The condensed consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements and notes for the year ended October 31, 2005 included in the Company's Annual Report on Form 10-K. Interim results are not necessarily indicative of results for the full year due to seasonal and other factors.

2. *New Accounting Pronouncements*

In November 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 151, "Inventory Costs an amendment of ARB No. 43, Chapter 4". SFAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The adoption of SFAS No. 151 did not have a significant impact on the Company's consolidated financial position, results of operation or cash flows.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections," which replaces APB Opinion No. 20, "Accounting Changes," and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements." SFAS No. 154 applies to all voluntary changes in accounting principles and requires retrospective application (a term defined by the statement) to prior periods' financial statements, unless it is impracticable to determine the effect of a change. It also applies to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company will adopt SFAS No. 154 in the first quarter of fiscal 2007, but does not expect the adoption of SFAS No. 154 to have a material impact on its financial condition, results of operations or cash flows.

In December 2004, the FASB issued SFAS No. 123(R) "Share-Based Payment". SFAS No. 123(R) requires that companies recognize compensation expense equal to the fair value of stock options or other share based payments. The Company adopted this standard during the six months ended April 30, 2006 using the modified prospective method. See Note 3 for a description of the impact of this standard on the Company's financial statements.

3. *Stock Based Compensation*

On November 1, 2005, the Company adopted the fair value recognition provisions of SFAS No. 123(R). Prior to November 1, 2005, the Company had accounted for stock-based payments under the recognition and measurement provisions of Accounting Principles Board ("APB") Opinion 25 and related interpretations, as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation." In accordance with APB 25, no compensation expense was required to be recognized for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant.

Under the modified prospective method of SFAS No. 123(R), compensation expense was recognized during the six months ended April 30, 2006 and includes compensation expense for all stock-based payments granted prior to, but not yet vested as of November 1, 2005, based on

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 and compensation expense for all stock based payments granted after November 1, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Company's financial results for the prior periods have not been restated.

As a result of adopting SFAS No. 123(R), during the six months ended April 30, 2006, the Company's net income is \$7.9 million lower than if it had continued to account for stock based compensation under APB 25 as it did for the six months ended April 30, 2005. Basic and diluted earnings per share for the six months ended April 30, 2006 would have been \$0.25 and \$0.24, respectively, if the Company had not adopted SFAS No. 123(R), compared to basic and diluted earnings per share of \$0.18 and \$0.18, respectively. Compensation expense was included as selling, general and administrative expense for the period. The impact on cost of goods sold was not significant. The adoption of SFAS No. 123(R) had no impact on the Company's cash flows.

Consistent with the valuation method used for the disclosure only provisions of SFAS No. 123, the Company is using the Black-Scholes option-pricing model to value compensation expense. Forfeitures are estimated at the date of grant based on historical rates and reduce the compensation expense recognized. The expected term of options granted is derived from historical data on employee exercises. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the date of grant. Expected volatility is based on the historical volatility of the Company's stock. For the three months ended April 30, 2006 and 2005 options were valued assuming risk-free interest rates of 4.9% and 4.2%, respectively, volatility of 43.8% and 52.2%, respectively, zero dividend yield, and expected lives of 5.2 and 5.3 years, respectively. The weighted average fair value of options granted was \$6.28 and \$7.42 for the three months ended April 30, 2006 and 2005, respectively. The Company records stock compensation expense using the graded vested method over the vesting period, which is generally three years. As of April 30, 2006, the Company had approximately \$25.1 million of unrecognized compensation expense expected to be recognized over a weighted average period of approximately 1.1 years.

The reported net income and net income per share for the three months and six months ended April 30, 2005 have been presented below to reflect the impact of the adoption of SFAS No. 123(R) had the Company been required to adopt this standard for the six months ended April 30, 2005.

	Three Months Ended April 30, 2005	Six Months Ended April 30, 2005
<i>In thousands, except per share amounts</i>		
Actual net income.....	\$ 34,667	\$ 48,881
Less stock-based employee compensation expense, net of tax	<u>3,781</u>	<u>5,594</u>
Pro forma net income.....	<u>\$ 30,886</u>	<u>\$ 43,287</u>
Actual net income per share	<u>\$ 0.29</u>	<u>\$ 0.41</u>
Pro forma net income per share	<u>\$ 0.26</u>	<u>\$ 0.37</u>
Actual net income per share, assuming dilution	<u>\$ 0.28</u>	<u>\$ 0.40</u>
Pro forma net income per share, assuming dilution	<u>\$ 0.25</u>	<u>\$ 0.35</u>

On March 24, 2006, the Company's shareholders approved the 2006 Restricted Stock Plan. A total of 1.0 million shares are reserved for issuance under the Restricted Stock Plan. As of April 30, 2006, no restricted shares have been granted under this plan.

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

4. Inventories

Inventories consist of the following:

<i>In thousands</i>	April 30, 2006	October 31, 2005
Raw materials	\$ 52,316	\$ 46,659
Work in-process	15,558	10,416
Finished goods	<u>334,159</u>	<u>329,321</u>
	<u>\$ 402,033</u>	<u>\$ 386,396</u>

5. Intangible Assets and Goodwill

A summary of intangible assets is as follows:

<i>In thousands</i>	April 30, 2006			October 31, 2005		
	Gross Amount	Amorti- zation	Net Book Value	Gross Amount	Amorti- zation	Net Book Value
Amortizable trademarks	\$ 5,407	\$ (1,561)	\$ 3,846	\$ 5,135	\$ (1,349)	\$ 3,786
Amortizable licenses	10,207	(3,488)	6,719	10,081	(2,940)	7,141
Other amortizable intangibles	26,805	(3,768)	23,037	28,757	(2,022)	26,735
Non-amortizable trademarks	<u>213,880</u>	<u>—</u>	<u>213,880</u>	<u>210,040</u>	<u>—</u>	<u>210,040</u>
	<u>\$256,299</u>	<u>\$ (8,817)</u>	<u>\$ 247,482</u>	<u>\$ 254,013</u>	<u>\$ (6,311)</u>	<u>\$ 247,702</u>

Certain trademarks and licenses will continue to be amortized by the Company using estimated useful lives of 10 to 25 years with no residual values. Intangible amortization expense for the six months ended April 30, 2006 and 2005 was \$2.6 million and \$1.2 million, respectively. Annual amortization expense is estimated to be approximately \$5.3 million in the fiscal year ending October 31, 2006, approximately \$5.0 million in the fiscal year ending October 31, 2007 and approximately \$3.8 million in the fiscal years ending October 31, 2009 and 2010. Goodwill related to the Company's segments is as follows:

<i>In thousands</i>	April 30, 2006	October 31, 2005
Americas	\$ 145,298	\$ 144,948
Europe	194,746	175,392
Asia/Pacific	<u>135,686</u>	<u>129,037</u>
	<u>\$ 475,730</u>	<u>\$ 449,377</u>

Goodwill increased \$26.4 million during the six months ended April 30, 2006 as a result of approximately \$15.1 million related to Rossignol and other acquisitions, and \$11.3 million due to the effect of changes in foreign currency exchange rates.

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

6. *Accumulated Other Comprehensive Income*

The components of accumulated other comprehensive income include changes in fair value of derivative instruments qualifying as cash flow hedges, the fair value of interest rate swaps and foreign currency translation adjustments. The components of accumulated other comprehensive income, net of income taxes, are as follows:

<i>In thousands</i>	April 30, <u>2006</u>	October 31, <u>2005</u>
Foreign currency translation adjustment	\$ 54,059	\$ 27,730
(Loss) gain on cash flow hedges and interest rate swaps.....	<u>(2,207)</u>	<u>2,362</u>
	<u>\$ 51,852</u>	<u>\$ 30,092</u>

7. *Segment Information*

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the Company's management in deciding how to allocate resources and in assessing performance. The Company operates in the outdoor market of the sporting goods industry in which the Company designs, produces and distributes clothing, winter sports and golf equipment, footwear, accessories and related products. The Company operates in three segments, the Americas, Europe and Asia/Pacific. Costs that support all three operating segments, including trademark protection, trademark maintenance and licensing functions are part of corporate operations. Corporate operations also includes sourcing income and gross profit earned from the Company's licensees. The Company's largest customer accounted for approximately 4% of the Company's net revenues for the six months ended April 30, 2006.

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Information related to the Company's operating segments is as follows:

<i>In thousands</i>	Three Months Ended April 30,	
	<u>2006</u>	<u>2005</u>
Revenues, net:		
Americas.....	\$ 250,042	\$ 199,192
Europe	217,149	176,272
Asia/Pacific	48,247	50,331
Corporate operations.....	1,490	1,058
	<u>\$ 516,928</u>	<u>\$ 426,853</u>
Gross profit:		
Americas.....	\$ 103,166	\$ 76,697
Europe	108,512	90,595
Asia/Pacific	22,045	25,541
Corporate operations.....	767	532
	<u>\$ 234,490</u>	<u>\$ 193,365</u>
Operating income:		
Americas.....	\$ 21,657	\$ 23,425
Europe	12,350	33,704
Asia/Pacific	(2,289)	6,340
Corporate operations	(13,066)	(9,418)
	<u>\$ 18,652</u>	<u>\$ 54,051</u>

<i>In thousands</i>	Six Months Ended April 30,	
	<u>2006</u>	<u>2005</u>
Revenues, net:		
Americas.....	\$ 470,760	\$ 358,466
Europe	478,301	308,862
Asia/Pacific	106,589	100,781
Corporate operations.....	2,420	1,604
	<u>\$ 1,058,070</u>	<u>\$ 769,713</u>
Gross profit:		
Americas.....	\$ 190,948	\$ 139,121
Europe	243,220	156,223
Asia/Pacific	47,857	49,823
Corporate operations.....	1,026	1,104
	<u>\$ 483,051</u>	<u>\$ 346,271</u>
Operating income:		
Americas.....	\$ 25,620	\$ 32,116
Europe	55,603	48,681
Asia/Pacific	679	13,695
Corporate operations	(25,994)	(17,018)
	<u>\$ 55,908</u>	<u>\$ 77,474</u>
Identifiable assets:		
Americas.....	\$ 735,377	\$ 456,947
Europe	1,043,136	470,273
Asia/Pacific	296,482	142,650
Corporate operations.....	57,420	96,046
	<u>\$ 2,132,415</u>	<u>\$ 1,165,916</u>

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

8. *Derivative Financial Instruments*

The Company is exposed to gains and losses resulting from fluctuations in foreign currency exchange rates relating to certain sales, royalty income, and product purchases of its international subsidiaries that are denominated in currencies other than their functional currencies. The Company is also exposed to foreign currency gains and losses resulting from domestic transactions that are not denominated in U.S. dollars, and to fluctuations in interest rates related to its variable rate debt. Furthermore, the Company is exposed to gains and losses resulting from the effect that fluctuations in foreign currency exchange rates have on the reported results in the Company's consolidated financial statements due to the translation of the operating results and financial position of the Company's international subsidiaries. As part of its overall strategy to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company uses various foreign currency exchange contracts and intercompany loans. In addition, interest rate swaps are used to manage the Company's exposure to the risk of fluctuations in interest rates.

Derivatives that do not qualify for hedge accounting but are used by management to mitigate exposure to currency risks are marked to fair value with corresponding gains or losses recorded in earnings. A gain of \$0.3 million was recognized related to these types of derivatives during the six months ended April 30, 2006. For all qualifying cash flow hedges, the changes in the fair value of the derivatives are recorded in other comprehensive income. As of April 30, 2006, the Company was hedging forecasted transactions expected to occur in the following 25 months. Assuming exchange rates at April 30, 2006 remain constant, \$2.2 million of losses, net of tax, related to hedges of these transactions are expected to be reclassified into earnings over the next 25 months.

On the date the Company enters into a derivative contract, management designates the derivative as a hedge of the identified exposure. The Company formally documents all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for entering into various hedge transactions. In this documentation, the Company identifies the asset, liability, firm commitment, or forecasted transaction that has been designated as a hedged item and indicates how the hedging instrument is expected to hedge the risks related to the hedged item. The Company formally measures effectiveness of its hedging relationships both at the hedge inception and on an ongoing basis in accordance with its risk management policy. The Company would discontinue hedge accounting prospectively (i) if management determines that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item, (ii) when the derivative expires or is sold, terminated, or exercised, (iii) if it becomes probable that the forecasted transaction being hedged by the derivative will not occur, (iv) because a hedged firm commitment no longer meets the definition of a firm commitment, or (v) if management determines that designation of the derivative as a hedge instrument is no longer appropriate. During the six months ended April 30, 2006, the Company reclassified into earnings a net loss of \$1.6 million resulting from the expiration, sale, termination, or exercise of derivative contracts.

The Company enters into forward exchange and other derivative contracts with major banks and is exposed to credit losses in the event of nonperformance by these banks. The Company anticipates, however, that these banks will be able to fully satisfy their obligations under the contracts. Accordingly, the Company does not obtain collateral or other security to support the contracts.

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

A summary of derivative contracts at April 30, 2006 is as follows:

<i>In thousands</i>	<u>Notional Amount</u>	<u>Maturity</u>	<u>Fair Value</u>
United States dollar	\$ 296,417	May 2006 – May 2008	\$ (3,560)
Interest rate swap	<u>38,182</u>	Jan 2007 – Sept 2009	<u>(77)</u>
	<u>\$ 334,599</u>		<u>\$ (3,637)</u>

9. *Business Acquisitions*

Effective July 31, 2005, the Company acquired Skis Rossignol SA (“Rossignol”), a wintersports and golf equipment manufacturer. Rossignol offers a full range of wintersports equipment under the Rossignol, Dynastar, Lange, Look and Kerma brands, and also sells golf products under the Cleveland Golf and Never Compromise brands. The Company has included the operations of Rossignol in its results since August 1, 2005. The purchase price, excluding transaction costs, included cash of approximately \$208.3 million, approximately 2.2 million restricted shares of the Company’s common stock, valued at \$28.9 million, a deferred purchase price obligation of approximately \$32.5 million, a liability of approximately \$16.9 million for the mandatory purchase of approximately 0.7 million outstanding public shares of Rossignol representing less than 5% of the share capital of Rossignol, and a liability of approximately \$2.0 million for the estimated fair value of 0.1 million fully vested Rossignol stock options. Estimated transaction costs totaled approximately \$16.0 million. The valuation of the common stock issued in connection with the acquisition was based on its quoted market price for the five days before and after the announcement date, discounted to reflect the estimated effect of its trading restrictions. The deferred purchase price obligation is expected to be paid in 2010 and will accrue interest equal to the 3-month euro interbank offered rate (“Euribor”) plus 2.35% (currently 5.2%). The mandatory purchase of the remaining Rossignol shares was required under French law as the Company had obtained over 95% of the outstanding shares of Rossignol through a combination of share purchases, including a public tender offer. The purchase of these shares was completed in the quarter ended October 31, 2005 and the Company now owns 100% of the shares in Rossignol. Upon the future exercise of the Rossignol stock options, the Company will purchase the newly issued shares from the Rossignol stock option holders, retaining 100% ownership in Rossignol. These Rossignol stock options are treated as variable for accounting purposes and subsequent changes in the value of these stock options are recorded as compensation expense in the Company’s consolidated statement of income. The Company acquired a majority interest in Cleveland Golf when it acquired Rossignol, but certain former owners of Cleveland Golf retained a minority interest of 36.37%. The Company and the minority owners have entered into a put/call arrangement whereby the minority owners of Cleveland Golf can require the Company to buy all of their interest in Cleveland Golf after 4.5 years and the Company can buy their interest at its option after 7 years, each at a purchase price generally determined by reference to a multiple of Cleveland Golf’s annual profits and the Company’s price-earnings ratio. As a result of the minority interest and put/call arrangement, the Company will account for Cleveland Golf as a step acquisition. In a step acquisition, where less than 100% of an entity is acquired, only a portion of the fair value adjustments are recorded in the acquiring company’s balance sheet equal to the percentage ownership in the acquired company. Based on this step acquisition accounting, the Company has recorded 63.63% of the fair value adjustments for Cleveland Golf in its balance sheet. Goodwill arises from synergies the Company believes can be achieved integrating Rossignol’s brands, products and operations with the Company’s, and is not expected to be deductible for income tax purposes. Amortizing intangibles consist of customer relationships, patents and athlete contracts with estimated useful lives of twenty, seven and two years, respectively. The acquired trademarks are non-amortizing as they have been determined to have indefinite lives.

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The allocation of purchase price is based on preliminary estimates and is subject to change (see Note 11). The following table summarizes the fair values of the assets acquired and the liabilities assumed at the date of the Rossignol acquisition in accordance with the purchase method of accounting:

<i>In thousands</i>	July 31, 2005
Cash acquired.....	\$ 64,396
Accounts receivable.....	96,763
Inventory	233,909
Other current assets	21,548
Fixed assets.....	115,321
Deferred income taxes.....	3,572
Other assets	3,296
Amortizing intangible assets.....	20,400
Trademarks.....	94,700
Goodwill	<u>248,312</u>
Total assets acquired	902,217
Other liabilities	181,711
Long term debt and lines of credit	365,126
Deferred income taxes.....	40,657
Minority interest	<u>10,109</u>
Net assets acquired	<u>\$ 304,614</u>

In connection with the acquisition of Rossignol, the Company has formulated the Rossignol Integration Plan ("the Plan"). As of April 30, 2006 the Company has recognized approximately \$29.1 million of liabilities related to the Plan. See Note 11 for further description of the Plan.

Effective August 1, 2005, the Company acquired 11 retail stores in Australia from Surfction Pty Ltd, Manly Boardriders Pty Ltd. and Sydney Boardriders Pty Ltd. ("Surfction"). The operations of Surfction have been included in the Company's results since August 1, 2005. The initial purchase price, excluding transaction costs, included cash of approximately \$21.4 million. Transaction costs totaled approximately \$1.0 million. The sellers are entitled to additional payments ranging from zero to approximately \$17.1 million if certain sales and margin targets are achieved through September 30, 2008. The amount of goodwill initially recorded for the transaction would increase if such contingent payments are made. Goodwill arises from synergies the Company believes can be achieved through Surfction's retail expertise and store presence in key locations in Australia, and is not expected to be deductible for income tax purposes. Amortizing intangibles consist of non-compete agreements with estimated useful lives of five years.

The allocation of purchase price is based on preliminary estimates and is subject to change based on the finalization of the purchase price allocation. The following table summarizes the fair values of the assets acquired and the liabilities assumed at the date of the Surfction acquisition in accordance with the purchase method of accounting:

<i>In thousands</i>	August 1, 2005
Inventory and other current assets.....	\$ 3,239
Fixed assets.....	4,839
Amortizing intangible assets.....	450
Goodwill	<u>21,285</u>
Total assets acquired.....	29,813
Other liabilities	<u>7,419</u>
Net assets acquired	<u>\$ 22,394</u>

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The Company paid cash of approximately \$28.4 million during the six months ended April 30, 2006, of which \$5.8 million relates to a payment to the former owners of the Asia/Pacific business, \$5.0 relates to a payment to the former owners of DC Shoes, Inc., and the remaining \$17.6 million relates primarily to insignificant acquisitions of certain other distributors, licensees and retail store locations.

10. *Indemnities and Guarantees*

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These include (i) intellectual property indemnities to the Company's customers and licensees in connection with the use, sale and/or license of Company products, (ii) indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, (iii) indemnities to vendors and service providers pertaining to claims based on the negligence or willful misconduct of the Company, and (iv) indemnities involving the accuracy of representations and warranties in certain contracts. The duration of these indemnities, commitments and guarantees varies and, in certain cases, may be indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential for future payments the Company could be obligated to make. The Company has not recorded any liability for these indemnities, commitments and guarantees in the accompanying consolidated balance sheets.

11. *Rossignol Integration Plan and Pre-acquisition Restructuring Plan*

In connection with the acquisition of Rossignol, the Company has formulated the Rossignol Integration Plan (the "Plan"). The Plan covers the global operations of Rossignol and the Company's existing businesses, and it includes the evaluation of facility relocations, nonstrategic business activities, redundant functions and other related items. The Company has not finalized the Plan, but as of April 30, 2006 has recognized approximately \$29.1 million of liabilities related to the Plan, including employee relocation and severance costs, moving costs, and other costs related primarily to the consolidation of Rossignol's administrative headquarters in Europe and the relocation of the Company's wintersports equipment sales and distribution operations in the United States. These liabilities were included in the allocation of the purchase price for Rossignol in accordance with Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination". Costs that are not associated with the acquired company but relate to activities or employees of the Company's existing operations are charged to earnings as incurred. Certain facilities owned by the acquired company are expected to be sold in connection with the Plan, while others are anticipated to be refinanced through sale-leaseback arrangements. Assets currently held for sale, primarily in the United States and France, total approximately \$18.9 million at April 30, 2006. The Plan has not been finalized as it relates primarily to facilities outside of the United States, and the Company's estimates of expected costs related to the U.S. aspects of the Plan may change. Accordingly, as uncertainties related to the Plan are resolved, additional liabilities related to facility relocations, the elimination of nonstrategic business activities and redundant functions, and other related costs could be recognized. These uncertainties are expected to be resolved within one year of the consummation date of the acquisition, and when determined, additional liabilities could be significant and would be recorded as adjustments to goodwill. If the Company has overestimated these costs, the excess will reduce goodwill in future periods. After finalization of the Plan, if the Company has underestimated these costs, additional liabilities recognized more than one year after the consummation date of the acquisition will be recorded in earnings.

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Activity and liability balances recorded as part of the Plan are as follows:

<i>In thousands</i>	<u>Workforce</u>	<u>Facility and Other</u>	<u>Total</u>
Recorded in purchase price allocation.....	\$ 3,673	\$ 1,574	\$ 5,247
Adjustment to purchase price allocation	17,463	752	18,215
Cash payments	(17)	(44)	(61)
Foreign currency translation	<u>(83)</u>	<u>(6)</u>	<u>(89)</u>
Balance, October 31, 2005	21,036	2,276	23,312
Adjustment to purchase price allocation	3,751	1,885	5,636
Cash payments	(2,133)	(94)	(2,227)
Foreign currency translation	<u>1,052</u>	<u>223</u>	<u>1,275</u>
Balance, April 30, 2006	<u>\$ 23,706</u>	<u>\$ 4,290</u>	<u>\$ 27,996</u>

Prior to the acquisition of Rossignol, a restructuring plan was announced related to Rossignol's French manufacturing facilities ("Pre-acquisition Restructuring Plan"). The costs associated with the Pre-acquisition Restructuring Plan consist of termination benefits achieved through voluntary early retirement and voluntary termination of certain employees.

Activity and liability balances recorded as part of the Pre-acquisition Restructuring Plan are as follows:

<i>In thousands</i>	<u>Workforce</u>
Balance, October 31, 2005.....	\$ 4,054
Cash payments.....	(2,230)
Adjustment to purchase price allocation.....	(1,454)
Foreign currency translation	<u>24</u>
Balance, April 30, 2006.....	<u>\$ 394</u>

12. Condensed Consolidating Financial Information

The Company has \$400 million in publicly registered senior notes. Obligations under the Company's senior notes are fully and unconditionally guaranteed by certain of its existing domestic subsidiaries. Cleveland Golf is expected to be added as a guarantor subsidiary during the three months ended July 31, 2006. The Company is required to present condensed consolidating financial information for Quiksilver, Inc. and its domestic subsidiaries within the notes to the consolidated financial statements in accordance with the criteria established for parent companies in the SEC's Regulation S-X, Rule 3-10(f). The following condensed consolidating financial information presents the results of operations, financial position and cash flows of Quiksilver Inc., its guarantor subsidiaries, its non-guarantor subsidiaries and the eliminations necessary to arrive at the information for the Company on a consolidated basis as of April 30, 2006 and October 31, 2005 and for the six months ended April 30, 2006 and 2005. The principal elimination entries eliminate investments in subsidiaries and intercompany balances and transactions. Due to the seasonality of the Company's quarterly operations, management has applied the estimated consolidated annual effective income tax rate to both the guarantor and non-guarantor subsidiaries for interim reporting purposes. In our consolidated financial statements for the fiscal year ending October 31, 2006, management will apply the actual income tax rate to both the guarantor and non-guarantor subsidiaries. These interim tax rates may differ from the actual annual effective income tax rates for both the guarantor and non-guarantor subsidiaries.

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING BALANCE SHEET

At April 30, 2006

<i>In thousands</i>	Quiksilver, Inc.	Wholly-owned Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Elimination	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 357	\$ 14,860	\$ 81,601	\$ —	\$ 96,818
Trade accounts receivable, net	—	160,736	322,242	—	482,978
Other receivables	761	1,953	23,919	—	26,633
Inventories	—	110,409	292,802	(1,178)	402,033
Deferred income taxes	—	22,531	21,689	—	44,220
Prepaid expenses and other current assets	<u>2,073</u>	<u>9,183</u>	<u>14,761</u>	<u>—</u>	<u>26,017</u>
Total current assets	3,191	319,672	757,014	(1,178)	1,078,699
Fixed assets, net	3,895	72,205	189,996	—	266,096
Intangible assets, net	2,504	47,736	197,242	—	247,482
Goodwill	—	125,025	350,705	—	475,730
Investment in subsidiaries	580,249	—	—	(580,249)	—
Other assets	12,232	5,296	27,936	—	45,464
Assets held for sale	—	4,225	14,719	—	18,944
Total assets	<u>\$ 602,071</u>	<u>\$ 574,159</u>	<u>\$ 1,537,612</u>	<u>\$ (581,427)</u>	<u>\$ 2,132,415</u>
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Lines of credit	\$ —	\$ 158	\$ 205,313	\$ —	\$ 205,471
Accounts payable	1,216	50,332	145,645	—	197,193
Accrued liabilities	12,368	23,401	111,836	(49)	147,556
Current portion of long-term debt	—	1,230	15,037	—	16,267
Income taxes payable	—	(2,581)	2,581	—	—
Intercompany balances	<u>45,225</u>	<u>9,593</u>	<u>(54,818)</u>	<u>—</u>	<u>—</u>
Total current liabilities	58,809	82,133	425,594	(49)	566,487
Long-term debt, net of current portion	433,460	116,440	134,900	—	684,800
Deferred income taxes	—	<u>32,122</u>	<u>42,218</u>	—	<u>74,340</u>
Total liabilities	492,269	230,695	602,712	(49)	1,325,627
Minority interest	10,353	—	—	—	10,353
Stockholders'/invested equity	<u>99,449</u>	<u>343,464</u>	<u>934,900</u>	<u>(581,378)</u>	<u>796,435</u>
Total liabilities and stockholders' equity	<u>\$ 602,071</u>	<u>\$ 574,159</u>	<u>\$ 1,537,612</u>	<u>\$ (581,427)</u>	<u>\$ 2,132,415</u>

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING BALANCE SHEET

At October 31, 2005

<i>In thousands</i>	Quiksilver, Inc.	Wholly-owned Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Elimination	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 1,177	\$ 20,816	\$ 53,605	\$ —	\$ 75,598
Trade accounts receivable, net	—	207,120	392,366	—	599,486
Other receivables	920	4,918	21,576	—	27,414
Inventories	—	118,548	268,888	(1,040)	386,396
Deferred income taxes	—	22,531	19,115	—	41,646
Prepaid expenses and other current assets	<u>1,788</u>	<u>6,588</u>	<u>13,443</u>	<u>—</u>	<u>21,819</u>
Total current assets	3,885	380,521	768,993	(1,040)	1,152,359
Fixed assets, net	2,679	66,604	172,696	—	241,979
Intangible assets, net	2,310	47,960	197,432	—	247,702
Goodwill	—	177,841	271,536	—	449,377
Investment in subsidiaries	578,719	—	—	(578,719)	—
Other assets	11,735	4,933	27,287	—	43,955
Assets held for sale	—	<u>4,225</u>	<u>19,004</u>	<u>—</u>	<u>23,229</u>
Total assets	<u>\$ 599,328</u>	<u>\$ 682,084</u>	<u>\$ 1,456,948</u>	<u>\$ (579,759)</u>	<u>\$ 2,158,601</u>
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current liabilities:					
Lines of credit	\$ —	\$ 6,138	\$ 213,975	\$ —	\$ 220,113
Accounts payable	1,486	78,859	132,062	—	212,407
Accrued liabilities	18,237	29,777	134,665	294	182,973
Current portion of long-term debt	—	1,230	49,603	—	50,833
Income taxes payable	—	14,872	12,304	—	27,176
Intercompany balances	<u>(63,906)</u>	<u>59,579</u>	<u>4,327</u>	<u>—</u>	<u>—</u>
Total current liabilities	(44,183)	190,455	546,936	294	693,502
Long-term debt, net of current portion	431,944	76,456	131,948	—	640,348
Deferred income taxes	—	21,441	60,187	—	81,628
Total liabilities	387,761	288,352	739,071	294	1,415,478
Minority interest	—	—	10,241	—	10,241
Stockholders'/invested equity	<u>211,567</u>	<u>393,732</u>	<u>707,636</u>	<u>(580,053)</u>	<u>732,882</u>
Total liabilities and stockholders' equity	<u>\$ 599,328</u>	<u>\$ 682,084</u>	<u>\$ 1,456,948</u>	<u>\$ (579,759)</u>	<u>\$ 2,158,601</u>

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING STATEMENT OF INCOME

Six Months Ended April 30, 2006

<i>In thousands</i>	Quiksilver, Inc.	Wholly-owned Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Elimination	Consolidated
Revenues, net.....	\$ 197	\$ 390,924	\$ 702,119	\$ (35,170)	\$1,058,070
Cost of goods sold	<u>—</u>	<u>238,653</u>	<u>360,093</u>	<u>(23,727)</u>	<u>575,019</u>
Gross profit	197	152,271	342,026	(11,443)	483,051
Selling, general and administrative expense	<u>24,871</u>	<u>131,190</u>	<u>282,440</u>	<u>(11,358)</u>	<u>427,143</u>
Operating (loss) income.....	(24,674)	21,081	59,586	(85)	55,908
Interest expense	18,515	2,023	4,002	—	24,540
Foreign currency loss (gain)	(683)	(8)	(302)	—	(993)
Minority interest and other expense	<u>112</u>	<u>—</u>	<u>299</u>	<u>—</u>	<u>411</u>
(Loss) income before provision for income taxes.....	(42,618)	19,066	55,587	(85)	31,950
Provision for income taxes.....	<u>(12,828)</u>	<u>5,739</u>	<u>16,707</u>	<u>—</u>	<u>9,618</u>
Net (loss) income.....	<u>\$ (29,790)</u>	<u>\$ 13,327</u>	<u>\$ 38,880</u>	<u>\$ (85)</u>	<u>\$ 22,332</u>

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING STATEMENT OF INCOME

Six Months Ended April 30, 2005

<i>In thousands</i>	Quiksilver, Inc.	Wholly-owned Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Elimination	Consolidated
Revenues, net.....	\$ 2,197	\$ 366,411	\$ 418,190	\$ (17,085)	\$ 769,713
Cost of goods sold	<u>—</u>	<u>225,349</u>	<u>203,826</u>	<u>(5,733)</u>	<u>423,442</u>
Gross profit	2,197	141,062	214,364	(11,352)	346,271
Selling, general and administrative expense	<u>16,054</u>	<u>110,473</u>	<u>153,685</u>	<u>(11,415)</u>	<u>268,797</u>
Operating (loss) income.....	(13,857)	30,589	60,679	63	77,474
Interest expense	1,029	2,886	1,143	—	5,058
Foreign currency loss (gain)	82	487	(394)	—	175
Minority interest and other expense	<u>—</u>	<u>—</u>	<u>145</u>	<u>—</u>	<u>145</u>
(Loss) income before provision for income taxes.....	(14,968)	27,216	59,785	63	72,096
Provision for income taxes.....	<u>(4,820)</u>	<u>8,764</u>	<u>19,271</u>	<u>—</u>	<u>23,215</u>
Net (loss) income.....	<u>\$ (10,148)</u>	<u>\$ 18,452</u>	<u>\$ 40,514</u>	<u>\$ 63</u>	<u>\$ 48,881</u>

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

Six Months Ended April 30, 2006

<i>In thousands</i>	Quiksilver, Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidated
Cash flows from operating activities:				
Net income	\$ (29,790)	\$ 13,327	\$ 38,795	\$ 22,332
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	269	9,247	21,836	31,352
Stock based compensation	11,324	—	—	11,324
Provision for doubtful accounts	—	(1,355)	4,565	3,210
Gain on sale of fixed assets	—	—	(19)	(19)
Foreign currency gain	(33)	—	(223)	(256)
Minority interest	112	—	799	911
Changes in operating assets and liabilities:				
Trade accounts receivable	—	45,254	83,338	128,592
Other receivables	159	2,980	(2,136)	1,003
Inventories	—	7,798	(9,842)	(2,044)
Prepaid expenses and other current assets	501	(3,142)	80	(2,561)
Other assets	(16)	(452)	(2,909)	(3,377)
Accounts payable	(270)	(28,812)	8,588	(20,494)
Accrued liabilities	(4,969)	(2,051)	(27,681)	(34,701)
Income taxes payable	—	(14,149)	(6,980)	(21,129)
Net cash (used in) provided by operating activities	(22,713)	28,645	108,211	114,143
Cash flows from investing activities:				
Capital expenditures	(1,679)	(14,652)	(26,405)	(42,736)
Business acquisitions, net of cash acquired	(2,417)	(5,000)	(21,030)	(28,447)
Net cash used in investing activities	(4,096)	(19,652)	(47,435)	(71,183)
Cash flows from financing activities:				
Borrowings on lines of credit	—	157	137,775	137,932
Payments on lines of credit	—	(6,376)	(168,383)	(174,759)
Borrowings on long-term debt	(1,267)	56,350	60,931	116,014
Payments on long-term debt	—	(16,366)	(91,001)	(107,367)
Proceeds from stock option exercises	4,666	—	—	4,666
Intercompany	22,505	(48,192)	25,687	—
Net cash provided by (used in) financing activities	25,904	(14,427)	(34,991)	(23,514)
Effect of exchange rate changes on cash	85	(522)	2,211	1,774
Net increase (decrease) in cash and cash equivalents	(820)	(5,956)	27,996	21,220
Cash and cash equivalents, beginning of period	1,177	20,816	53,605	75,598
Cash and cash equivalents, end of period	<u>\$ 357</u>	<u>\$ 14,860</u>	<u>\$ 81,601</u>	<u>\$ 96,818</u>

QUIKSILVER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

Six Months Ended April 30, 2005

<i>In thousands</i>	Quiksilver, Inc.	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidated
Cash flows from operating activities:				
Net income	\$ (10,148)	\$ 18,452	\$ 40,577	\$ 48,881
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	79	7,342	9,205	16,626
Provision for doubtful accounts	—	1,206	2,418	3,624
Loss on sale of fixed assets	—	13	270	283
Foreign currency (gain) loss	(37)	(102)	604	465
Interest accretion	—	—	998	998
Changes in operating assets and liabilities:				
Trade accounts receivable	—	(18,048)	(44,970)	(63,018)
Other receivables	(4,056)	2,394	2,300	638
Inventories	—	(137)	3,168	3,031
Prepaid expenses and other current assets	(329)	(2,154)	(3,144)	(5,627)
Other assets	230	(932)	(2,382)	(3,084)
Accounts payable	2,341	2,800	(422)	4,719
Accrued liabilities	8,799	(16,714)	(1,449)	(9,364)
Income taxes payable	—	2,205	3,556	5,761
Net cash (used in) provided by operating activities	<u>(3,121)</u>	<u>(3,675)</u>	<u>10,729</u>	<u>3,933</u>
Cash flows from investing activities:				
Capital expenditures	(1,803)	(9,462)	(13,467)	(24,732)
Deposit on planned acquisition	(59,588)	—	—	(59,588)
Business acquisitions, net of cash acquired	<u>(4,150)</u>	<u>(11,824)</u>	<u>(5,415)</u>	<u>(21,389)</u>
Net cash used in investing activities	<u>(65,541)</u>	<u>(21,286)</u>	<u>(18,882)</u>	<u>(105,709)</u>
Cash flows from financing activities:				
Borrowings on lines of credit	—	—	35,172	35,172
Payments on lines of credit	—	—	(21,536)	(21,536)
Borrowings on long-term debt	95,664	6,182	2,303	104,149
Payments on long-term debt	—	(627)	(6,409)	(7,036)
Proceeds from stock option exercises	3,403	91	—	3,494
Intercompany	<u>(26,775)</u>	<u>15,495</u>	<u>11,280</u>	<u>—</u>
Net cash provided by financing activities	<u>72,292</u>	<u>21,141</u>	<u>20,810</u>	<u>114,243</u>
Effect of exchange rate changes on cash	—	—	345	345
Net increase (decrease) in cash and cash equivalents	3,630	(3,820)	13,002	12,812
Cash and cash equivalents, beginning of period	<u>(1,070)</u>	<u>9,489</u>	<u>46,778</u>	<u>55,197</u>
Cash and cash equivalents, end of period	<u>\$ 2,560</u>	<u>\$ 5,669</u>	<u>\$ 59,780</u>	<u>\$ 68,009</u>

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Unless the context indicates otherwise, when we refer to “Quiksilver”, “we”, “us”, “our”, or the “Company” in this Form 10-Q, we are referring to Quiksilver, Inc. and its subsidiaries on a consolidated basis. You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and related notes thereto contained elsewhere in this report. The information contained in this quarterly report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our securities. We urge you to carefully review and consider the various disclosures made by us in this report and in our other reports filed with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended October 31, 2005 and subsequent reports on Form 8-K, which discuss our business in greater detail. The section entitled “Risk Factors” set forth in Item 1A of our Annual Report on Form 10-K, and similar discussions in our other SEC filings, discuss some of the important risk factors that may affect our business, results of operations and financial condition. You should carefully consider those risks, in addition to the information in this report and in our other filings with the SEC, before deciding to purchase, hold or sell our securities.

We began operations in 1976 as a California company making boardshorts for surfers in the United States under a license agreement with the *Quiksilver* brand founders in Australia. Our product offering expanded in the 1980s as we grew our distribution channels. After going public in 1986 and purchasing the rights to the *Quiksilver* brand in the United States from our Australian licensor, we further expanded our product offerings and began to diversify. In the early 1990s, we acquired the European licensee of *Quiksilver* and introduced *Roxy*, our surf brand for teenage girls. We also expanded demographically in the 1990s by adding products for boys, girls, toddlers and men, and we introduced our proprietary retail store concept, Boardriders Clubs, which displays the heritage and products of *Quiksilver* and *Roxy*. In 2000, we acquired the international *Quiksilver* and *Roxy* trademarks, and in 2002, we acquired our licensees in Australia and Japan. In May 2004, we acquired DC Shoes to expand our presence in action sports-inspired footwear.

In July 2005, we acquired Skis Rossignol, S.A., a wintersports and golf equipment manufacturer. Rossignol offers a full range of wintersports equipment under the *Rossignol*, *Dynastar*, *Lange*, *Look* and *Kerma* brands, and also sells golf products under the *Cleveland Golf* and *Never Compromise* brands. The acquisition was effective July 31, 2005 and we have included the operations of Rossignol in our results since August 1, 2005. In July 2005, we issued \$400 million in senior notes that bear a coupon interest rate of 6.875% and are due April 15, 2015. These senior notes were used to fund a portion of the Rossignol purchase price and to refinance certain existing indebtedness.

Over the past 35 years, *Quiksilver* has been established as a leading global brand representing the casual, youth lifestyle associated with boardriding sports. With our acquisition of Rossignol, we have added a collection of leading ski equipment brands to our company that we believe will be the foundation for a full range of technical ski apparel, sportswear and accessories. Also, as part of our acquisition of Rossignol, we acquired a majority interest in Roger Cleveland Golf Company, Inc., a leading producer of wedges and golf clubs in the United States.

We believe that our acquisition of Rossignol provides us with multiple authentic brands in both snow and golf. We believe that Rossignol’s technical knowledge, combined with our current lifestyle brands, will enable us to produce and market apparel, equipment, footwear, accessories and related products for consumers in a broad cross section of the outdoor market. Furthermore, we believe the combination of our existing global expertise in branded apparel and footwear, along with Rossignol’s expertise in branded wintersports equipment, provide us with a diversified platform for continued growth and enhanced operating efficiencies. Our products are sold throughout the world, primarily in surf shops, ski shops, snow shops, skate shops and specialty stores.

Our acquisition of Rossignol has had, and is expected to continue to have a significant impact on our financial results. Our revenues and expenses have increased substantially. Also, our overall profit margins have been negatively impacted because Rossignol has historically generated lower profit margins than we have, and this trend is expected to continue in the foreseeable future. In addition,

Rossignol's business has historically been seasonal, with revenues and operating profits generally higher in August through December, which will affect our consolidated quarterly results. We are substantially more leveraged as a result of the debt incurred in connection with the acquisition, and we have an increased amount of capital committed to manufacturing functions.

We operate in the outdoor market of the sporting goods industry in which we design, produce and distribute branded apparel, wintersports and golf equipment, footwear, accessories and related products. We operate in three segments, the Americas, Europe and Asia/Pacific. The Americas segment includes revenues primarily from the U.S. and Canada. The European segment includes revenues primarily from Western Europe. The Asia/Pacific segment includes revenues primarily from Australia, Japan, New Zealand and Indonesia.

We operate in markets that are highly competitive, and our ability to evaluate and respond to changing consumer demands and tastes is critical to our success. If we are unable to remain competitive and maintain our consumer loyalty, our business will be negatively affected. We believe that our historical success is due to the development of an experienced team of designers, artists, sponsored athletes, engineers, technicians, researchers, merchandisers, pattern makers, and contractors. Our team and the heritage and current strength of our brands has helped us remain competitive in our markets. Our success in the future will depend on our ability to continue to design products that are acceptable to the marketplace and competitive in the areas of quality, brand image, technical specifications, distribution methods, price, customer service, and intellectual property protection.

Results of Operations

The table below shows the components in our statements of income and other data as a percentage of revenues:

<i>Statement of Income data</i>	Three Months Ended		Six Months Ended	
	April 30,		April 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Revenues, net.....	100.0%	100.0%	100.0%	100.0%
Gross profit.....	45.4	45.3	45.7	45.0
Selling, general and administrative expense	<u>41.8</u>	<u>32.6</u>	<u>40.4</u>	<u>34.9</u>
Operating income.....	3.6	12.7	5.3	10.1
Interest expense	2.3	0.8	2.3	0.7
Foreign currency, minority interest and other expense.....	<u>0.2</u>	<u>(0.1)</u>	<u>0.0</u>	<u>0.0</u>
Income before provision for income taxes	1.1	12.0	3.0	9.4
Provision for income taxes.....	<u>0.4</u>	<u>3.9</u>	<u>0.9</u>	<u>3.0</u>
Net income	<u>0.7%</u>	<u>8.1%</u>	<u>2.1%</u>	<u>6.4%</u>
 <i>Other data</i>				
EBITDA ⁽¹⁾	<u>7.5%</u>	<u>14.8%</u>	<u>9.4%</u>	<u>12.2%</u>

⁽¹⁾ EBITDA is defined as net income before (i) interest expense, (ii) income tax expense, (iii) depreciation and amortization, and (iv) non-cash stock based compensation expense. EBITDA is not defined under generally accepted accounting principles (“GAAP”), and it may not be comparable to similarly titled measures reported by other companies. We use EBITDA, along with other GAAP measures, as a measure of profitability because EBITDA helps us to compare our performance on a consistent basis by removing from our operating results the impact of our capital structure, the effect of operating in different tax jurisdictions, the impact of our asset base, which can differ depending on the book value of assets and the accounting methods used to compute depreciation and amortization, and the effect of non-cash stock based compensation expense. We believe it is useful to investors for the same reasons. EBITDA has limitations as a profitability measure in that it does not include the interest expense on our debts, our provisions for income taxes, the effect of our expenditures for capital assets and certain intangible assets and the effect of non-cash compensation expense. Following is a reconciliation of net income to EBITDA:

	Three Months Ended April 30,		Six Months Ended April 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Net income.....	\$ 3,729	\$ 34,667	\$ 22,332	\$ 48,881
Provision for income taxes.....	1,833	16,464	9,618	23,215
Interest expense	11,949	3,269	24,540	5,058
Depreciation and amortization	15,849	8,824	31,352	16,626
Non-cash stock compensation expense	5,564	—	11,324	—
EBITDA.....	<u>\$ 38,924</u>	<u>\$ 63,224</u>	<u>\$ 99,166</u>	<u>\$ 93,780</u>

Three Months Ended April 30, 2006 Compared to Three Months Ended April 30, 2005

Our total net revenues for the three months ended April 30, 2006 increased 21% to \$516.9 million from \$426.9 million in the comparable period of the prior year. Revenue from our Rossignol and Cleveland Golf businesses, which were acquired on July 31, 2005, totaled \$86.2 million for the three months ended April 30, 2006. Revenues in the Americas increased 26% to \$250.0 million for the three months ended April 30, 2006 from \$199.2 million in the comparable period of the prior year, and European revenues increased 23% to \$217.1 million from \$176.3 million for those same periods. As measured in euros, Quiksilver Europe’s primary functional currency, revenues in the current year’s quarter increased 33% compared to the prior year. Asia/Pacific revenues decreased 4% to \$48.2 million for the three months ended April 30, 2006 from \$50.3 million for the three months ended April 30, 2005. In Australian dollars, Quiksilver Asia/Pacific’s primary functional currency, Asia/Pacific revenues increased 2% compared to the prior year.

In the Americas, revenues in our men’s category, which includes the Quiksilver Young Men’s, Boys, Toddlers, Quiksilver edition, Hawk and DC brands, increased 3% to \$100.0 million from \$97.1 million in the comparable period of the prior year, while revenues in our women’s category, which includes the Roxy, Roxy Girl, Teenie Wahine, DC, Raisins, Leilani and Radio Fiji brands, decreased 1% to \$100.3 million from \$101.7 million. Revenues from our wintersports and golf equipment brands which include Rossignol, Dynastar, Look, Lange, Kerma, Cleveland Golf, Never Compromise, Lib Technologies, Gnu, Bent Metal and Roxy equipment, totaled \$49.4 million for the current year’s quarter compared to \$0.4 million in the comparable period of the prior year. The increase in the Americas men’s revenues came primarily from the DC brand partially offset by a decrease in our Hawk revenue which no longer generates product revenue after our license of such brand to a third party. The decrease in the Americas women’s revenues came primarily from growth in the Roxy brand which was more than offset by a decrease in revenue due to the discontinuation of our private label swimwear product line. The increase in wintersports and golf equipment revenue came primarily from the newly acquired Rossignol and Cleveland Golf businesses. In Europe and as reported in dollars, men’s revenues increased 4% to \$119.5 million from \$115.3 million, while women’s revenues increased 6% to \$64.7 million from \$61.0 million. Our European wintersports and golf equipment revenue of \$33.0 million came from our newly acquired Rossignol and Cleveland Golf businesses. The European men’s increase was primarily due to growth in the Quiksilver brand and to a lesser extent the DC brand, which were partially offset by the negative effects of changes in foreign currency exchange rates. As measured in euros, European men’s revenues increased 12%. The women’s revenue increase reflects growth in the Roxy brand partially

offset by the negative effects of changes in foreign currency exchange rates. As measured in euros, European women's revenues increased 15%. In Asia/Pacific, the decrease in revenues came primarily from an increase in revenues due to our newly acquired Rossignol and Cleveland Golf businesses which was more than offset by decreases in our other brand revenues in Australia and the negative effects of changes in foreign currency exchange rates.

Our consolidated gross profit margin for the three months ended April 30, 2006 increased slightly to 45.4% from 45.3% in the comparable period of the prior year. The Americas' gross profit margin increased to 41.3% from 38.5%, while the European gross profit margin decreased to 50.0% from 51.4%, and the Asia/Pacific gross profit margin decreased to 45.7% from 50.7% for those same periods. The increase in the Americas' gross profit margin was primarily due to improved margins on our DC and Quiksilver brands and a higher percentage of sales through company owned retail stores where we earn both the wholesale and retail margins, partially offset by higher sales of our wintersports and golf equipment businesses, which operate at a lower gross margin than our other businesses. Our European gross profit margin decrease was primarily due to the negative impact of our newly acquired wintersports and golf equipment businesses partially offset by a higher percentage of sales through company-owned retail stores. In Asia/Pacific, the gross profit margin decrease was primarily due to sales from our lower margin wintersports and golf equipment businesses and lower margins on our other brands, partially offset by a higher percentage of sales through company-owned retail stores.

Selling, general and administrative expense ("SG&A") for the three months ended April 30, 2006 increased 55% to \$215.8 million from \$139.3 million in the comparable period of the prior year. Americas' SG&A increased 53% to \$81.5 million from \$53.3 million in the comparable period of the prior year, while European SG&A increased 69% to \$96.2 million from \$56.9 million and Asia/Pacific SG&A increased 27% to \$24.3 million from \$19.2 million for those same periods. As a percentage of revenues, SG&A increased to 41.8% for the three months ended April 30, 2006 from 32.6% for the three months ended April 30, 2005.

The consolidated increase in SG&A as a percentage of revenue was primarily caused by our newly acquired wintersports equipment business. This business has a seasonally low shipping period during the three months ended April 30, 2006, causing the ratio of SG&A to revenue to be negatively impacted. The consolidated increase in SG&A as a percentage of revenue also increased due to \$5.5 million in stock based compensation expense recorded in the current period as a result of adopting SFAS No. 123(R) and the cost of additional retail stores.

Interest expense for the three months ended April 30, 2006 increased to \$11.9 million from \$3.3 million in the comparable period of the prior year. This increase was primarily due to debt incurred and assumed in connection with the acquisition of Rossignol.

Our foreign currency gain amounted to \$0.5 million for the three months ended April 30, 2006 compared to a gain of \$0.3 million in the comparable period of the prior year. These gains resulted primarily from the foreign currency contracts we used to hedge the risk of translating the results of our international subsidiaries into U.S. dollars.

The effective income tax rate for the three months ended April 30, 2006 was 33.0% compared to 32.2% for the three months ended April 30, 2005. Our effective income tax rate for the six months ended April 30, 2006 is 30.1%, which is lower than the prior year's annual rate because a higher percentage of our 2006 profits are expected to be generated in countries with lower tax rates and from foreign tax credits.

Net income for the three months ended April 30, 2006 was \$3.7 million or \$0.03 per share on a diluted basis, compared to \$34.7 million, or \$0.28 per share on a diluted basis, in the comparable period of the prior year. Basic net income per share was \$0.03 per share for the three months ended April 30, 2006 compared to \$0.29 per share in the comparable period of the prior year. EBITDA decreased 38% to \$38.9 million from \$63.2 million for those same periods.

Six Months Ended April 30, 2006 Compared to Six Months Ended April 30, 2005

Our total net revenues for the six months ended April 30, 2006 increased 37% to \$1,058.1 million from \$769.7 million in the comparable period of the prior year. Our revenue from the Rossignol and Cleveland Golf businesses, which were acquired on July 31, 2005, totaled \$277.9 million for the six months ended April 30, 2006. Revenues in the Americas increased 31% to \$470.8 million for the six months ended April 30, 2006 from \$358.5 million in the comparable period of the prior year, and European revenues increased 55% to \$478.3 million from \$308.9 million for those same periods. As measured in euros, revenues in the first six months of the current year increased 69% as compared to the prior year. Asia/Pacific revenues increased 6% to \$106.6 million in the six months ended April 30, 2006 compared to \$100.8 million in the comparable period of the prior year. As measured in Australian dollars, revenues increased 11% over the comparable period of the prior year.

In the Americas, revenues in our men's category increased 8% to \$183.8 million from \$170.4 million in the comparable period of the prior year, while revenues in our women's category decreased 1% to \$183.9 million from \$186.4 million. Revenues from our wintersports and golf brands totaled \$101.0 million in the current year's six-month period as compared to revenues of \$1.7 million in the comparable period of the prior year. The increase in the Americas men's revenues came primarily from an increase in the DC brand and to a lesser extent from the Quiksilver brand. The decrease in the Americas women's revenues came primarily from growth in Roxy, which was more than offset by a decrease in revenue due to the discontinuation of our private label swimwear product line. The increase in wintersports and golf equipment revenue came primarily from the newly acquired Rossignol and Cleveland Golf businesses. In Europe and as reported in dollars, men's revenues decreased 2% to \$207.8 million from \$212.1 million, while women's revenues increased 14% to \$110.1 million from \$96.7 million. Our European wintersports and golf equipment revenue of \$160.5 million came from our newly acquired Rossignol and Cleveland Golf businesses. The European men's decrease was primarily due to growth in the Quiksilver and DC brands which were more than offset by the negative effects of changes in foreign currency exchange rates. As measured in euros, European men's revenue increased 7%. The women's increase reflects growth in the Roxy brand partially offset by the negative effects of changes in foreign currency exchange rates. As measured in euros, women's revenues increased 24%. In Asia/Pacific, the increase in revenues came primarily from the newly acquired Rossignol and Cleveland Golf businesses, partially offset by decreases in our other brand revenue in Australia and to a lesser extent, decreases caused by the negative effects of changes in foreign currency exchange rates.

Our consolidated gross profit margin for the six months ended April 30, 2006 increased to 45.7% from 45.0% in the comparable period of the prior year. The Americas' gross profit margin increased to 40.6% from 38.8%, while the European gross profit margin increased to 50.9% from 50.6%, and the Asia/Pacific gross profit margin decreased to 44.9% from 49.4% for those same periods. The increase in the Americas' gross profit margin was primarily due to improved margins on our DC and Quiksilver brands, and a higher percentage of sales through company owned retail stores where we earn both the wholesale and retail margins, partially offset by higher sales from our wintersports and golf equipment businesses, which operate at a lower gross margin than our other businesses. Our European gross profit margin increase was primarily due to a higher percentage of our sales through company owned retail stores partially offset by sales from our newly acquired wintersports and golf equipment businesses. In Asia/Pacific, the gross profit margin decrease was primarily due to sales from our lower margin wintersports and golf equipment businesses and lower margins on our other brands, partially offset by a higher percentage of sales through company-owned retail stores.

SG&A for the six months ended April 30, 2006 increased 59% to \$427.1 million from \$268.8 million in the comparable period of the prior year. Americas' SG&A increased 55% to \$165.3 million from \$107.0 million in the comparable period of the prior year, European SG&A increased 74% to \$187.6 million from \$107.5 million, and Asia/Pacific SG&A increased 31% to \$47.2 million from \$36.1 million for those same periods. As a percentage of revenues, SG&A increased to 40.4% for the six months ended April 30, 2006 from 34.9% for the six months ended April 30, 2005.

The consolidated increase in SG&A as a percentage of revenue was primarily due to increased SG&A expenses from our newly acquired wintersports equipment business. Our wintersports equipment

business has a seasonally low shipping period during the three months ended April 30, 2006, causing the ratio of SG&A to revenue to be negatively impacted. The consolidated increase in SG&A as a percentage of revenue also increased due to \$11.3 million in stock based compensation recorded in the current period as a result of adopting SFAS No. 123(R) on November 1, 2005 and the cost of additional retail stores.

Interest expense for the six months ended April 30, 2006 increased to \$24.5 million from \$5.1 million in the comparable period of the prior year. This increase was primarily due to debt incurred and assumed in connection with the acquisition of Rossignol.

Our foreign currency gain amounted to \$1.0 million for the six months ended April 30, 2006 compared to a loss of \$0.2 million in the comparable period of the prior year. This gain and loss resulted primarily from the foreign currency contracts we used to hedge the risk of translating the results of our international subsidiaries into U.S. dollars.

The effective income tax rate for the six months ended April 30, 2006 decreased to 30.1% from 32.2% in the comparable period of the prior year. This improvement resulted primarily because a higher percentage of our 2006 profits are expected to be generated in countries with lower tax rates and from foreign tax credits.

Net income for the six months ended April 30, 2006 was \$22.3 million or \$0.18 per share on a diluted basis, compared to \$48.9 million, or \$0.40 per share on a diluted basis, in the comparable period of the prior year. Basic net income per share was \$0.18 per share for the six months ended April 30, 2006 from \$0.41 per share in the comparable period of the prior year. EBITDA increased 6% to \$99.2 million from \$93.8 million for those same periods.

Financial Position, Capital Resources and Liquidity

We generally finance our working capital needs and capital investments with operating cash flows and bank revolving lines of credit. Multiple banks in the United States, Europe and Australia make these lines of credit available to us. Term loans are also used to supplement these lines of credit and are typically used to finance long-term assets. In fiscal 2005, we issued \$400 million of senior notes to fund a portion of the Rossignol purchase price and to refinance certain existing indebtedness.

The net increase in cash and cash equivalents for the six months ended April 30, 2006 was \$21.2 million compared to \$12.8 million in the comparable period of the prior year. Cash and cash equivalents totaled \$96.8 million at April 30, 2006 compared to \$75.6 million at October 31, 2005, while working capital was \$512.2 million at April 30, 2006 compared to \$458.9 million at October 31, 2005. We believe our current cash balance and current lines of credit are adequate to cover our seasonal working capital and other requirements for the foreseeable future, and that increases in our lines of credit can be obtained as needed to fund future growth.

Cash Flows

We generated \$114.1 million of cash from operating activities in the six months ended April 30, 2006 compared to \$3.9 million for the comparable period of the prior year. This \$110.2 million increase in cash provided was primarily due to changes in accounts receivable, inventories and accounts payable. During the six months ended April 30, 2006, the decrease in accounts receivable provided cash of \$128.6 million compared to cash used of \$63.0 million during the six months ended April 30, 2005, an increase in cash provided of \$191.6 million. The change in inventories, net of the change in accounts payable, used cash of \$22.5 million during the six months ended April 30, 2006 compared to cash provided of \$7.8 million for the same period of the prior year, a net decrease in cash provided of \$30.3 million. An additional \$51.1 million was used during the six months ended April 30, 2006 compared to the comparable period of the prior year primarily due to changes in other operating assets and liabilities.

Capital expenditures totaled \$42.7 million for the six months ended April 30, 2006, compared to \$24.7 million in the comparable period of the prior year. These investments include company-owned retail stores and ongoing investments in manufacturing, computer and warehouse equipment. We used \$28.4

million of cash for acquisitions, of which \$5.8 million relates to a payment to the former owners of our Asia/Pacific business, \$5.0 million relates to a payment to the former owners of DC Shoes, Inc., and the remaining \$17.6 million relates primarily to acquisitions of certain other licensees, distributors and retail store locations.

During the six months ended April 30, 2006, net cash used in financing activities totaled \$23.5 million, compared to \$114.2 million provided by financing activities in the comparable period of the prior year. Borrowings decreased as we generated increased cash from our operating activities.

Trade Accounts Receivable and Inventories

Our trade accounts receivable decreased 19% to \$483.0 million at April 30, 2006 from \$599.5 million at October 31, 2005. Accounts receivable in the Americas decreased 21% to \$216.3 million at April 30, 2006 from \$273.0 million at October 31, 2005, while European accounts receivable decreased 15% to \$223.8 million from \$263.8 million, and Asia/Pacific accounts receivable decreased 32% to \$42.9 million from \$62.7 million for those same periods. Our April 30, 2006 balance sheet includes \$123.0 million of accounts receivable from our newly acquired Rossignol and Cleveland Golf businesses. Accounts receivable related to our other businesses compared to April 30, 2005, increased 8% in the Americas, 6% in Europe and decreased 9% in Asia/Pacific. The increase in Americas accounts receivable from our other businesses primarily relates to the timing of collections from our customers. The increase in accounts receivable in our European segment from our other businesses primarily relates to higher revenues and the timing of shipments. The decrease in Asia/Pacific accounts receivable from our other businesses primarily relates to decreased sales in Australia. Included in accounts receivable are approximately \$39.0 million of value added tax and goods and services tax related to foreign accounts receivable. Such taxes are not reported as net revenues and as such, must be deducted from accounts receivable to accurately compute days sales outstanding. Overall average days sales outstanding increased by approximately 10 days at April 30, 2006 compared to April 30, 2005. Of this increase, seven days related to our newly acquired wintersports and golf equipment businesses, and the remaining three days related to the timing of collections from our customers in our other businesses in the Americas.

Consolidated inventories increased 4% to \$402.0 million at April 30, 2006 from \$386.4 million at October 31, 2005. Inventories in the Americas decreased 4% to \$157.5 million from \$164.4 million at October 31, 2005, while European inventories increased 10% to \$194.6 million from \$176.9 million, and Asia/Pacific inventories increased 11% to \$49.9 million from \$45.1 million for those same periods. Our April 30, 2006 inventory balance includes \$191.0 million in inventories from our newly acquired Rossignol and Cleveland Golf businesses. Inventories related to our other businesses remained consistent in the Americas compared to April 30, 2005, while inventories in Europe increased 29%, and inventories in Asia/Pacific increased 74% for that same period. The increase in our European and Asia/Pacific inventories primarily relates to the increase in inventories due to additional retail locations, acquired licensees and distributors and increased inventory in Japan to support growth. Consolidated average annual inventory turnover was approximately 3.1 at April 30, 2006 compared to approximately 4.1 at April 30, 2005. Excluding the effect of the Rossignol and Cleveland Golf inventories, average inventory turnover was 3.9 at April 30, 2006.

Commitments

We paid \$5.8 million related to the achievement of certain sales and earnings targets to the former owners of our Asia/Pacific business during the six months ended April 30, 2006. This amount represents the final payment related to this acquisition. In addition, we paid \$5.0 million related to the achievement of certain sales and earnings targets to the former owners of DC Shoes, Inc.

In connection with the acquisition of Rossignol, we have formulated the Rossignol Integration Plan (the "Plan"). The Plan covers the global operations of Rossignol and our existing businesses, and it includes the evaluation of facility relocations, nonstrategic business activities, redundant functions and other related items. We have not finalized the Plan, but as of April 30, 2006 we had recognized \$29.1 million of liabilities related to the Plan, including employee relocation and severance costs, moving costs, and other costs related primarily to the consolidation of Rossignol's administrative headquarters in Europe and the

relocation of our wintersports equipment sales and distribution operations in the United States. As of April 30, 2006, we have paid approximately \$2.3 million related to these integration activities. Costs that are not associated with Rossignol but relate to activities or employees of our existing operations will be charged to earnings as incurred. Certain facilities owned by Rossignol are expected to be sold in connection with the Plan, while others are anticipated to be refinanced through sale-leaseback arrangements. Assets currently held for sale, primarily in the United States and France, totaled approximately \$18.9 million at April 30, 2006. The Plan has not been finalized as it relates to facilities outside of the United States, and our estimates of expected costs related to the U.S. aspects of the Plan may change. Accordingly, as uncertainties related to the Plan are resolved, additional liabilities related to facility relocations, the elimination of nonstrategic business activities and redundant functions, and other related costs could be recognized. These uncertainties are expected to be resolved within one year of the consummation date of the acquisition, and when determined, additional liabilities could be significant and would be recorded as adjustments to goodwill. If we have overestimated these costs, the excess will reduce goodwill in future periods. Conversely, if we have underestimated these costs, additional liabilities recognized more than one year after the consummation date of the acquisition will be recorded in earnings.

Critical Accounting Policies

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. To prepare these financial statements, we must make estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates also affect our reported revenues and expenses. Judgments must also be made about the disclosure of contingent liabilities. Actual results could be significantly different from these estimates. We believe that the following discussion addresses the accounting policies that are necessary to understand and evaluate our reported financial results.

Revenue Recognition

Revenues are recognized when the risk of ownership and title passes to our customers. Generally, we extend credit to our customers and do not require collateral. None of our sales agreements with any of our customers provide for any rights of return. However, we do approve returns on a case-by-case basis at our sole discretion to protect our brands and our image. We provide allowances for estimated returns when revenues are recorded, and related losses have historically been within our expectations. If returns are higher than our estimates, our earnings would be adversely affected.

Accounts Receivable

It is not uncommon for some of our customers to have financial difficulties from time to time. This is normal given the wide variety of our account base, which includes small surf shops, medium-sized retail chains, and some large department store chains. Throughout the year, we perform credit evaluations of our customers, and we adjust credit limits based on payment history and the customer's current creditworthiness. We continuously monitor our collections and maintain a reserve for estimated credit losses based on our historical experience and any specific customer collection issues that have been identified. Historically, our losses have been consistent with our estimates, but there can be no assurance that we will continue to experience the same credit loss rates that we have experienced in the past. Unforeseen, material financial difficulties of our customers could have an adverse impact on our profits.

Inventories

We value inventories at the cost to purchase and/or manufacture the product or the current estimated market value of the inventory, whichever is lower. We regularly review our inventory quantities on hand, and adjust inventory values for excess and obsolete inventory based primarily on estimated forecasts of product demand and market value. Demand for our products could fluctuate significantly. The demand for our products could be negatively affected by many factors, including the following:

- weakening economic conditions;
- terrorist acts or threats;
- unanticipated changes in consumer preferences;

- reduced customer confidence in the retail market; and
- unseasonable weather.

Some of these factors could also interrupt the production and/or importation of our products or otherwise increase the cost of our products. As a result, our operations and financial performance could be negatively affected. Additionally, our estimates of product demand and/or market value could be inaccurate, which could result in an understated or overstated provision required for excess and obsolete inventory.

Long-Lived Assets

We acquire tangible and intangible assets in the normal course of our business. We evaluate the recoverability of the carrying amount of these long-lived assets (including fixed assets, trademarks licenses and other amortizable intangibles) whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss would be recognized when the carrying value exceeds the undiscounted future cash flows estimated to result from the use and eventual disposition of the asset. Impairments, if any, would be recognized in operating earnings. We continually use judgment when applying these impairment rules to determine the timing of the impairment tests, the undiscounted cash flows used to assess impairments, and the fair value of a potentially impaired asset. The reasonableness of our judgment could significantly affect the carrying value of our long-lived assets.

Goodwill

We evaluate the recoverability of goodwill at least annually based on a two-step impairment test. The first step compares the fair value of each reporting unit with its carrying amount including goodwill. If the carrying amount exceeds fair value, then the second step of the impairment test is performed to measure the amount of any impairment loss. Fair value is computed based on estimated future cash flows discounted at a rate that approximates our cost of capital. Such estimates are subject to change, and we may be required to recognize impairment losses in the future.

Income Taxes

Current income tax expense is the amount of income taxes expected to be payable for the current year. A deferred income tax asset or liability is established for the expected future consequences of temporary differences in the financial reporting and tax bases of assets and liabilities. We consider future taxable income and ongoing prudent and feasible tax planning strategies in assessing the value of our deferred tax assets. If we determine that it is more likely than not that these assets will not be realized, we would reduce the value of these assets to their expected realizable value, thereby decreasing net income. Evaluating the value of these assets is necessarily based on our judgment. If we subsequently determined that the deferred tax assets, which had been written down would, in our judgment, be realized in the future, the value of the deferred tax assets would be increased, thereby increasing net income in the period when that determination was made.

Stock-Based Compensation Expense

Effective November 1, 2005, we adopted the fair value recognition provisions of SFAS 123(R), using the modified prospective transition method, and therefore have not restated prior periods' results. Under this method we recognize compensation expense for all stock-based payments granted after November 1, 2005 and prior to but not yet vested as of November 1, 2005, in accordance with SFAS 123(R). Under the fair value recognition provisions of SFAS 123(R), we recognize stock-based compensation net of an estimated forfeiture rate and only recognize compensation cost for those shares expected to vest using the graded vested method over the requisite service period of the award. Prior to SFAS 123(R) adoption, we accounted for stock-based payments under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and accordingly, we were not required to recognize compensation expense for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant.

Determining the appropriate fair value model and calculating the fair value of stock-based payment awards require the input of highly subjective assumptions, including the expected life of the stock-based payment awards and stock price volatility. We use the Black-Scholes option-pricing model to value compensation expense. The assumptions used in calculating the fair value of stock-based payment awards represent management's best estimates, but the estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. See Note 3 to the Consolidated Condensed Financial Statements for a further discussion on stock-based compensation.

Foreign Currency Translation

A significant portion of our revenues are generated in Europe, where we operate with the euro as our functional currency, and a smaller portion of our revenues are generated in Asia/Pacific, where we operate with the Australian dollar and Japanese Yen as our functional currencies. Our European revenues in the United Kingdom are denominated in British pounds, and some European and Asia/Pacific product is sourced in U.S. dollars, both of which result in exposure to gains and losses that could occur from fluctuations in foreign exchange rates. Our assets and liabilities that are denominated in foreign currencies are translated at the rate of exchange on the balance sheet date. Revenues and expenses are translated using the average exchange rate for the period. Gains and losses from translation of foreign subsidiary financial statements are included in accumulated other comprehensive income or loss.

As part of our overall strategy to manage our level of exposure to the risk of fluctuations in foreign currency exchange rates, we enter into various foreign exchange contracts generally in the form of forward contracts. For all contracts that qualify as cash flow hedges, we record the changes in the fair value of the derivatives in other comprehensive income. We also use other derivatives that do not qualify for hedge accounting to mitigate our exposure to currency risks. These derivatives are marked to fair value with corresponding gains or losses recorded in earnings.

New Accounting Pronouncements

See Note 2 – New Accounting Pronouncements for a discussion of future pronouncements that may affect our financial reporting.

Forward-Looking Statements

All statements included in this report, other than statements or characterizations of historical fact, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Examples of forward-looking statements include, but are not limited to, statements regarding the trends and uncertainties in our financial condition and results of operations. These forward-looking statements are based on our current expectations, estimates and projections about our industry, management's beliefs, and certain assumptions made by us and speak only as of the date of this report. Forward-looking statements can often be identified by words such as "anticipates," "expects," "intends," "plans," "predicts," "believes," "seeks," "estimates," "may," "will," "should," "would," "could," "potential," "continue," "ongoing," and similar expressions, and variations or negatives of these words. In addition, any statements that refer to expectations, projections, guidance, forecasts or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. These statements are not guarantees of future results and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statement as a result of various factors, including, but not limited to, the following:

- our ability to achieve the financial results that we anticipate, or have experienced in the past;
- our ability to fully realize the benefits we anticipate from our acquisition of Rossignol;
- the impact of our substantial leverage on our ability to generate cash flows or obtain financing to fund our anticipated growth strategies and the cost of such financing;
- our plans to expand internationally;
- our intention to introduce new products and enter into new joint ventures;
- our plans to open new retail stores;
- payments due on contractual commitments;
- future expenditures for capital projects;
- our ability to continue to maintain our brand image and reputation;
- our ability to remain compliant with our debt covenants;
- integration of acquired businesses and future acquisitions;
- general economic and business conditions;
- foreign exchange rate fluctuations; and
- changes in political, social and economic conditions and local regulations, particularly in Europe and Asia.

Given these uncertainties, investors are cautioned not to place too much weight on such forward looking statements. We are not obligated to update these forward-looking statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency

We are exposed to financial statement gains and losses as a result of translating the operating results and financial position of our international subsidiaries. We translate the local currency statements of income of our foreign subsidiaries into U.S. dollars using the average exchange rate during the reporting period. Changes in foreign exchange rates affect our reported profits and distort comparisons from period to period. By way of example, when the U.S. dollar strengthens compared to the euro, there is a negative effect on our reported results for Quiksilver Europe because it takes more profits in euros to generate the same amount of profits in stronger U.S. dollars. In addition, the statements of income of Quiksilver Asia/Pacific are translated from Australian dollars and Japanese yen into U.S. dollars, and there is a negative effect on our reported results for Quiksilver Asia/Pacific when the U.S. dollar is stronger in comparison to Australian dollar or Japanese yen.

European revenues increased 69% in euros during the six months ended April 30, 2006 compared to the six months ended April 30, 2005. As measured in U.S. dollars and reported in our consolidated statements of income, European revenues increased 55% as a result of a stronger U.S. dollar versus the euro in comparison to the prior year.

Asia/Pacific revenues increased 11% in Australian dollars during the six months ended April 30, 2006 compared to the six months ended April 30, 2005. As measured in U.S. dollars and reported in our consolidated statements of income, Asia/Pacific revenues increased 6% as a result of a stronger U.S. dollar versus the Australian dollar in comparison to the prior year.

Our foreign currency and interest rate risks are discussed in our Annual Report on Form 10-K for the year ended October 31, 2005 in Item 7A.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of April 30, 2006, the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of April 30, 2006.

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended April 30, 2006 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security-Holders

Our Annual Meeting of Stockholders was held on March 24, 2006. A total of 111,698,265 shares of our common stock were present or represented by proxy at the meeting, representing more than 91.79% of our shares outstanding as of the January 27, 2006 record date. The matters submitted for a vote and the related election results are as follows:

Election of ten nominees to serve as directors until the next annual meeting and until their respective successors shall be elected and qualified. The result of the vote taken was as follows:

	<u>Votes For</u>	<u>Votes Withheld</u>		
Douglas K. Ammerman.....	107,791,308	3,906,957		
William M. Barnum, Jr.	108,312,071	3,386,194		
Laurent Boix-Vives.....	104,475,875	7,222,390		
Charles E. Crowe.....	107,119,612	4,578,653		
Charles S. Exon.....	107,112,101	4,586,164		
Michael H. Gray.....	108,315,838	3,382,427		
Timothy M. Harmon.....	109,791,864	1,906,401		
Bernard Mariette.....	107,115,445	4,582,820		
Robert B. McKnight, Jr.	108,775,389	2,922,876		
Franck Riboud.....	81,152,219	30,546,046		
	<u>Votes For</u>	<u>Votes Against</u>	<u>Votes Abstained</u>	<u>Broker Non-Votes</u>
Amendment of the Quiksilver, Inc. 2000 Stock Incentive Plan.....	85,132,198	9,467,546	58,428	17,040,093
Approval of the Quiksilver, Inc. 2006 Restricted Stock Plan.....	61,489,011	33,049,981	64,403	17,094,670

Item 6. Exhibits

Exhibits

- 10.1 Quiksilver, Inc. 2000 Stock Incentive Plan, as amended and restated on March 24, 2006 (incorporated by reference to Exhibit 10.1 of the Company's Form 8-K filed on March 28, 2006).
- 10.2 Quiksilver, Inc. 2006 Restricted Stock Plan (incorporated by reference to Exhibit 10.2 of the Company's Form 8-K filed on March 28, 2006).
- 31.1 Rule 13a-14(a)/15d-14(a) Certifications – Principal Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certifications – Principal Financial Officer
- 32.1 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2003 – Chief Executive Officer
- 32.2 Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2003 – Chief Financial Officer

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.

QUIKSILVER, INC., a Delaware corporation

June 9, 2006

/s/ Steven L. Brink

Steven L. Brink
Chief Financial Officer and Treasurer
(Principal Accounting Officer)