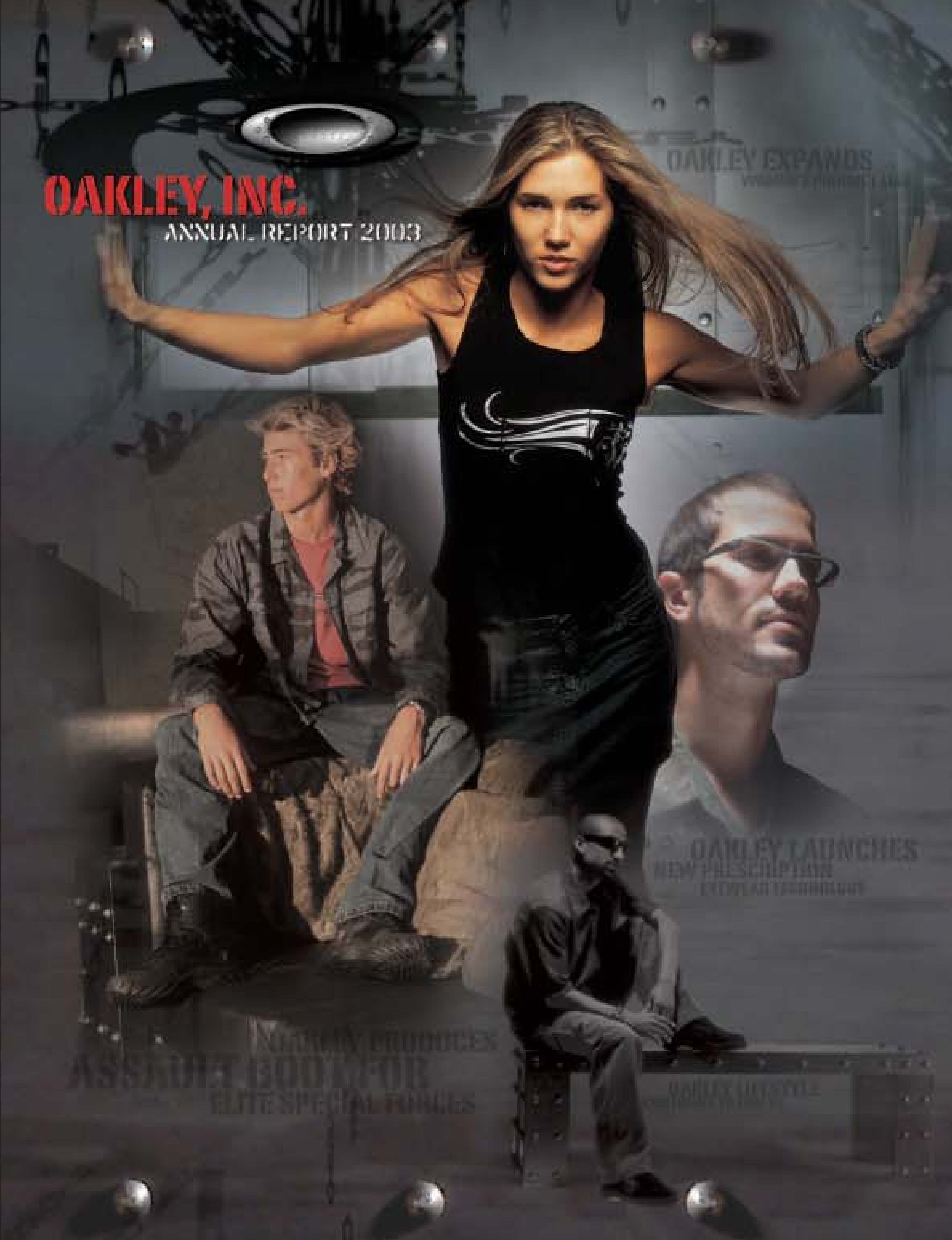
OAKLEY, INC.
ANNUAL REPORT 2003



LETTER TO SHAREHOLDERS

To Our Shareholders:

In 1998, we launched diversification strategies involving product, geography and distribution channels to reduce what we felt were unhealthy levels of concentration in each.

Five years later, as a direct result of those strategies, our business has grown and changed:

- Since 1998, net sales have grown at an annual compounded rate of 17.6%, rising from $231.9 million to $521.5 million.

- In 2003, newer category gross sales totaled $165.1 million, or 29 percent of total gross sales, comprised of:

- Apparel & accessories: $76.0 million (vs. $11.4 in 1998)

- Prescription eyewear: $42.7 million (vs. $2.9 in 1998)

- Footwear: $36.5 million (vs. $2.6 million in 1998)

- Watches: $9.9 million (vs. $2.4 million in 1998)

- International net sales of $264.5 million in 2003 were more than half our total, having grown at an annual compounded rate of 22.6 percent since 1998.

- We established a network of over 100 Oakley retail stores, from zero in 1998, accounting for sales of $53.2 million in 2003, more than ten percent of total net sales.

Based on those metrics, one might be tempted to conclude that our diversification strategy has been a great success.

Well, it hasn't. Not by a long shot.

I say that because over that same 5-year period, net income has grown at an annual compound rate of just 9.7% and has declined in each of the past three years to $38.2 million in 2003 from a peak of $51.1 million in 2000.

Sunglass unit sales, which totaled 4 million pair in 1998, peaked in 2000 at nearly 5 million pair, and have suffered three consecutive years of decline, falling 11 percent in 2003 to 4.2 million pair.

It's easy to see the correlation: As an integrated sunglass manufacturer, our margins and profitability are still highly dependent on sunglass sales to leverage the fixed costs of our manufacturing operations.

It would be easy to blame the past three years of sunglass sales and earnings declines on the economy, the terrorists, the weather or the war. Sure they've played a part, but Oakley's not the kind of company that shifts blame elsewhere. We take responsibility for, and pride in, our own financial results the same way we take responsibility for, and pride in, our inventions that stretch the boundaries of science and design.

So the most responsible way to portray the past five years is as a period of investment during which we've built infrastructure, recruited talent, forged new distribution channels, taken ownership of distribution in key international markets, engineered a powerful portfolio of kick-ass products and learned to work together as a bigger, more complex team.

The next five years offer the biggest opportunity of our 28-year history – the opportunity to indoctrinate a whole new generation of consumers into the Oakley culture and, by doing so, grow to $1 billion in sales with significantly improved earnings.

Oakley has always targeted the elusive 18-25-year-old market, placing us in a perpetual race to be among the first brands to connect with the next generation of consumers who enter that age demographic. The Oakley brand speaks to an unconventional lifestyle that encompasses select sports, music and fashion and is the domain of risk-takers – people on the front lines who influence market trends by defining a generation's rebellion.

This year's Winter X Games witnessed an amazing medal performance by Oakley's best athletes. With record attendance and viewership by the 18- to 25-year-old consumer, the Games produced a spontaneous Oakley commercial with fans and athletes alike rocking in our apparel from head to toe.

A new team of young-gun marketers, led by Jamin Jannard, are on a mission to grow our territory within the very market that helped make Oakley an investment opportunity in the first place.

Our product design and marketing programs for 2004 reflect a new and clearer understanding of Oakley's role as a lifestyle brand for our core demographic. We believe this evolution in thinking will improve the growth potential of our various product categories.

The good news is that the Oakley brand now has far more potential points of interface through which to connect with consumers.

In 1998 it was all about their eyes.

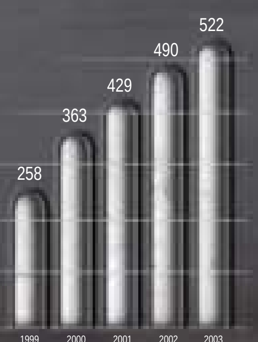
Today, we can go after their eyes, heads, legs, arms, wrists, torsos and feet to burn the Oakley brand into the one part of their body that ultimately matters: their mind – the only place a brand truly exists.

The past five years have forged a team whose once purely iconoclastic philosophy has been tempered with measured response to external forces. Oakley today is more focused, better equipped and more dangerous to competitors than ever. We are infected with a passionate frenzy – an energy that inspires us to believe that, given the right environment, the next few years could be a true breakout period for our business.

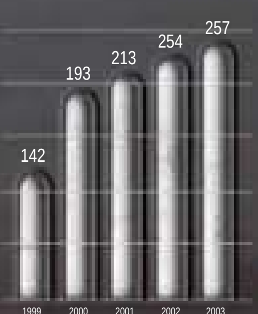
WE'RE ON THE FRONT LINES...
RIGHT WHERE
OAKLEY BELONGS.

See you on the other side.

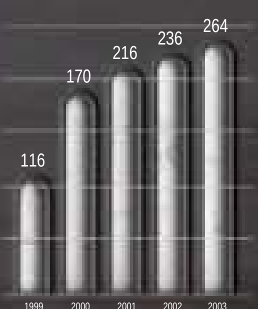
Jim Jannard,
Chairman and Chief Executive Officer



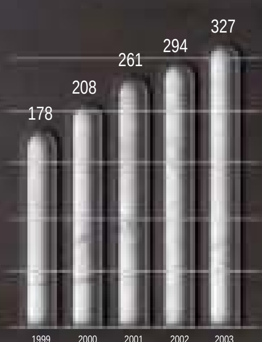
NET SALES
(in millions)



U.S. NET SALES
(in millions)



INTERNATIONAL NET SALES
(in millions)



SHAREHOLDERS' EQUITY
(in millions)

Form 10-K

OAKLEY INC - OO

Filed: March 15, 2004 (period: December 31, 2003)

Annual report which provides a comprehensive overview of the company for the past year

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO
SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

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

**For the fiscal year ended December 31, 2003
Commission File Number: 1-13848**

Oakley, Inc.

(Exact name of registrant as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)		**95-3194947** (IRS Employer ID No.)

One Icon **Foothill Ranch, California** (Address of principal executive offices)		**92610** (ZIP Code)

Registrant's telephone number, including area code (949) 951-0991

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

Title of each class		Name of each exchange on which registered
Common Stock, par value $.01 per share		New York Stock Exchange

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

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 90 days. Yes ☒ No ☐

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☒ No ☐

Aggregate market value of the Registrants common stock held by non-affiliates of the Registrant computed by reference to the closing price as reported on the New York Stock Exchange on June 30, 2003: $296,121,253

Number of shares of common stock, $.01 par value, outstanding as of the close of business on March 8, 2004: 68,029,827 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the proxy statement for the registrant's 2004 Annual Shareholders Meeting are incorporated by reference into Part II and Part III herein.

Oakley, Inc.
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Part I

Business

General

Oakley, Inc. (referenced here as the "Company" or "Oakley") is a Washington corporation formed in March 1994 to succeed to the assets and liabilities of Oakley, Inc., a California corporation that commenced operations in 1977 and began to sell sunglasses in 1984. The Company is an innovation-driven designer, manufacturer and distributor of consumer products that include high-performance eyewear, footwear, watches, apparel and accessories. The Company believes its principal strength is its ability to develop products that demonstrate superior performance and aesthetics through proprietary technology and styling. The Company holds 545 patents and 976 trademarks worldwide that protect its designs and innovations.

Forward-Looking Statements

When used in this document, the words "believes," "anticipates," "expects," "estimates," "intends," "may," "plans," "predicts," "will" or the negative thereof and similar expressions are intended to identify, in certain circumstances, forward-looking statements. Such statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those projected, including: risks related to the company's ability to manage rapid growth; the ability to identify qualified manufacturing partners; the ability to coordinate product development and production processes with those partners; the ability of those manufacturing partners and the company's internal production operations to increase production volumes on raw materials and finished goods in a timely fashion in response to increasing demand and enable the company to achieve timely delivery of finished goods to its retail customers; the ability to provide adequate fixturing to existing and future retail customers to meet anticipated needs and schedules; the dependence on eyewear sales to Sunglass Hut which is owned by a major competitor and, accordingly, could materially alter or terminate its relationship with the company; the company's ability to expand distribution channels and its own retail operations in a timely manner; unanticipated changes in general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by retailers; continued weakness of economic conditions could continue to reduce or further reduce demand for products sold by the company and could adversely affect profitability, especially of the company's retail operations; further terrorist acts, or the threat thereof, could continue to adversely affect consumer confidence and spending, could interrupt production and distribution of product and raw materials and could, as a result, adversely affect the company's operations and financial performance; the ability of the company to integrate acquisitions without adversely affecting operations; the ability to continue to develop and produce innovative new products and introduce them in a timely manner; the acceptance in the marketplace of the company's new products and changes in consumer preferences; reductions in sales of products, either as the result of economic or other conditions or reduced consumer acceptance of a product, could result in a buildup of inventory; the ability to source raw materials and finished products at favorable prices to the company; the potential effect of periodic power crises on the company's operations including temporary blackouts at the company's facilities; foreign currency exchange rate fluctuations; earthquakes or other natural disasters concentrated in Southern California where substantially all of the companies operations are based and the company's ability to identify and execute successfully cost control initiatives. Because of these uncertainties, prospective investors are cautioned not to place undue reliance on such statements. The Company undertakes no obligation to update these forward-looking statements.

The company makes available through its corporate website at www.oakley.com, free of charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after such reports are filed or furnished to the Securities and Exchange Commission.

Also available at our website are the following corporate governance materials: Code of Business Conduct and Ethics; Code of Ethics for Chief Executive and Senior Financial Officers; Corporate Governance Guidelines; and Charters of the Audit Committee, Compensation and Stock Option Committee and Nominating and Corporate Governance Committee. Any of the foregoing materials may also be obtained, free of charge, by written request to: Corporate Secretary, Oakley, Inc., One Icon, Foothill Ranch, California 92610.

Product Design and Development

Oakley is a consumer products company that uses innovative technology for the design and development of sunglasses, prescription eyewear, apparel, footwear, watches, goggles and accessories. To date, the Company has designed these categories using its own resources in order to preserve brand image, which the Company believes will bring greater respect and demand for Oakley's products over the long term.

State-of-the-art technology maintains efficiency, precision and speed in the Company's product development cycle. Stereolithographic computer modeling is combined with CAD/CAM liquid-laser prototyping to create fully detailed prototypes of eyewear, footwear and accessories. Rapid iteration of working models allows for extensive design testing before final production. After the development stage is complete, the finalized sculpture can be used directly in preparation of production tooling.

The Company's products undergo extensive testing throughout development. The American National Standards Institute (ANSI) and the American Society for Testing and Materials (ASTM) have established specific testing criteria for eyewear. These tests analyze product safety and provide quantitative measure of optical quality, UV protection, light transmission and impact resistance. In addition, the Company performs a broad range of eyewear coatings durability testing and mechanical integrity testing that includes extremes of UV, heat, condensation and humidity. With strict guidelines from the ASTM and other industry authorities, Oakley footwear and apparel are tested to ensure quality, performance and durability that meet or exceed these standards. Research and development expense during the years ended December 31, 2003, 2002 and 2001 were $14,308,000, $16,016,000 and $11,318,000 respectively.

Eyewear Technology and Products

Among the Company's most important patents are those which guard its achievements in dual-spherical lens technology and the associated optical advances, and innovations in frame design and functionality. The proprietary technologies employed in lens cutting, etching and coating, as well as the Company's significant investment in specialized equipment, are matched with exclusive formulations of production materials to achieve the superior optical quality, safety and performance of Oakley eyewear.

Oakley's patented*XYZ Optics*® represents a major breakthrough in lens technology. Precise geometric orientation provides optical correction on three axes, not just two. The resulting lens allows light to be received over essentially the full angular range of vision while minimizing distortion caused by disparate refraction along that range—an advance that increases clarity for all angles of view. This allows for wrapped, raked-back lens configurations that enhance peripheral vision and protection against sun, wind and side impact.

High-performance sports application eyewear featuring Oakley's patented*POLARIC ELLIPSOID*™ lens geometry*(M Frame*®, *Pro M Frame*® and *Zeros*®) have demonstrated superior optical clarity when compared to similar products of principal competitors. Developed specifically for toroidal lenses (which use different measurements for top-to-bottom vs. side-to-side curvature), this proprietary geometry allows the Company to produce single-lens sports shields that provide enhanced coverage and protection while reducing distortion at all angles of vision. Although the Company's patent relating to this proprietary geometry will expire in 2004, the expiration of this patent is not expected to have a material impact on the Company. See "Intellectual Property" below.

Plutonite® lens material and*Iridium*® lens coatings are among the Company's most prominent advances in eyewear.*Plutonite*® is a proprietary material used to produce lenses of exceptional optical clarity. The material inherently blocks 100% of all UVA, UVB, UVC and harmful blue light. Rendered as lenses of extremely high durability and low weight, it offers superior impact protection when matched with the Company's eyewear frames. *Iridium* ® is a metallic oxide that improves contrast and thereby enhances perception of detail. A full spectrum of available *Iridium* ® lens coatings allows the wearer to tune transmission for any given light condition. The coating has become very popular for eyewear used in demanding sports such as skiing and cycling, and in high altitude use.

In 1999 the Company introduced a polarized lens choice for consumers. Unlike most polarized lenses, which stack multiple layers together using adhesive which compromises optical clarity, durability and lens integrity, Oakley uses a patented lens technology to maintain precision optics by molecular fusing of the polarized filter between thin *Plutonite* ® surfaces. Oakley then injection molds liquid *Plutonite* ® onto the filter to create a true polarized lens with patented *XYZ Optics* ® and superior optical clarity.

The Company continues to raise the bar of performance with innovative engineering in frame design. A proprietary three-point fit serves to retain optical alignment while eliminating the discomfort of ordinary frames that mount with unbalanced pressure points. The *Wire* ® frames are rendered from *C-5*— a durable, lightweight alloy of five metallic compounds. *O Matter* ® frames are composed of a lightweight synthetic that retains durability while allowing critical flex. As the only 3-D sculptured, hypoallergenic, all-metal frames on earth, *X Metal* ® is a family of eyewear named for a proprietary metal blend that exhibits an extraordinary strength-to-weight ratio. *X Metal* ® frames are produced with a unique metallurgical process and are designed to utilize breakthroughs in architectural mechanics that allow the consumer to tailor the fit.

Gross sunglass sales for 2003 were $310.4 million. Retail pricing for the Company's*O Matter*® sunglass ranged from $55 to $240; the*Wire*® styles ranged from $120 to $315; the *Magnesium* ™ styles ranged from $215 to $235 and the *X-Metal* ® styles ranged in retail price from $275 to $400.

Prescription Eyewear Technology and Products

In March 2001, the Company released its first line of ophthalmic-specific frames and currently has a comprehensive prescription program encompassing both ophthalmic frames and corrective lenses. The ophthalmic specific frame collection is a combination of sculpture, fit and function. There are several shapes and sizes for the consumer to choose from and a variety of materials used—*Magnesium*™*, C-5* , *X Metal*® and Rx *O Matter*®*.* As part of the Company's *Plutonite* ® prescription lens offering, the Company sells a single lens product that is ideally suited for the sports enthusiast. The Rx *M Frame*® utilizes a proprietary technology that enables the wearer to have the ultimate protection and widest range of visual acuity. To complement the single lens product, the Company also offers a dual lens program that is an ideal choice for the consumer who is interested in a more traditional eyewear frame or one of Oakley's many high-wrap sunglass frames. Oakley *Plutonite*® prescription lenses are surfaced and finished in the Company's prescription lens processing labs in the United States and Ireland. This control over the lens processing operation allows the Company to control the quality of the lens and process it within tolerances that exceed industry standards.

The Company's sunglass and clear prescription lenses are offered for any prescription ready or sunglass frame that eye care professionals have on display in their stores. The lenses are not limited to use with Oakley prescription ready and Oakley sunglass frames. The Company offers 19 colors from which the consumer may choose, including polarized, *Iridium*® and clear options. Single vision and progressive lens designs are also offered. Prescription eyewear gross sales were $42.7 million for 2003.

Approximately 78 percent of the company's prescription eyewear sales were generated by the prescription eyewear frame line, which now consists of 23 styles with retail prices ranging from $120-$295. The company's prescription lenses accounted for the remaining 22 percent of prescription eyewear sales with retail prices ranging from $120-$380.

Apparel Technology and Products

Addressing the apparel needs of men and women, the Company has invested in a world-class lab that allows for 100% in-house testing during research and development of garment products. Digital technologies allow the Company to design and create in three dimensions. All pieces are engineered to fit the body as contoured spatial forms—not flat cutouts—so articulation and fit can be optimized. The Company utilizes core technologies to build technical apparel for professional competition, and thereby achieves crossover into technical lifestyle. Innovations that enhance product durability, performance and comfort for professional athletes are then made available to the general public.

The Company released 535 apparel styles and accessories during 2003. Spring apparel releases for 2003, totaling 223 new styles, included an introduction of Oakley denim for men and the launch of board shorts for women. Fall 2003 apparel releases totaled 312 new styles, which included an increased focus in technical outerwear with 46 new designs. The Company's key styles incorporated AirVantage technology, a self regulating insulation system invented by Gore. The Company expanded its lifestyle product line and its women's product line. The women's line totaled 116 pieces and men's totaled 196 pieces. Categories include: golf, mountain bike, surf, lifestyle, lifestyle athletic, fleece and tees.

Gross sales of apparel and apparel accessories were $76.0 million for the full year, with the largest components being fleece, lifestyle and outerwear products, together with substantial sales of the company's accessories line.

Footwear Technology and Products

With continued advancement in the design and manufacturing of footwear, the Company is utilizing proprietary*Net Shape*™ technology to create shoes with superior fit throughout the full range of motion. Instead of creating parts separately and forcing their consolidation, true unibody construction is achieved with CAD/CAM engineering, allowing components to form an integrated system. A design change in any part of the shoe is seamlessly integrated into other components and finalized data is passed directly to production equipment. This translates to improved functionality and comfort, as well as enhanced durability by preventing weaknesses that could result from misaligned or mismatched components.

Twenty-one new footwear styles were released in the year 2003. Introductions included the*Elite Special Forces Standard Issue Assault Boot/Shoe,* part of the Company's military/industrial product line, three new sandal lines, four new golf shoes and twelve new lifestyle shoes.

Footwear gross sales were $36.5 million for the full year, with product retail prices ranging from $50-$400.

Wristwatch Technology and Products

The Company offers a comprehensive line of premium wristwatches. The range of performance accuracy extends to the level of six-jewel high precision Swiss movement. The Company currently produces self-powering wristwatches, true analog quartz systems and a precision analog chronograph. In 2003, the Company terminated further development of digital watch models to focus on analog watch products allowing for more sculpture and styling to be designed into the watches.

Watch gross sales were $9.9 million for the full year as the Company realigned its product development and sales efforts to focus on premium analog watch designs and distribution. The

Company achieved strong sales of the new GMT watch introduced in the second half of 2003 and continued strength of the*Detonator®*,*Crush™2.0* and *Crush™ 2.5* analog product lines. Retail pricing for the Company's watch products ranged from $120-$1,500.

Goggle Technology and Products

The culmination of more than 20 years in the goggle business has resulted in what the Company believes to be the world's most optically correct goggles for motocross, mountain bike, snow and water recreation. Available in a number of styles, the Company's goggles include features such as scratch-resistant Lexan lenses, conical frames and multi-layered face foams. Updated in 2000, the Company's *MX O Frame* ® continues to improve upon its championship legacy in motocross. The *A Frame* ® was the world's first optically correct dual-lens snow goggle and is engineered to optimize protection, as well as the clarity and range of peripheral and downward vision. A triple layer of face foam insulates and cushions the contact surface for the ultimate in thermal shielding and comfort. In 2002, the Company introduced the *Wisdom* ™ goggle, featuring increased lens sizing for greater visual range and interchangeable strap connections to accommodate helmets.

The Company's goggle products as of December 31, 2003 target snow, motocross and water sports with retail prices ranging from $30-$140. Goggle gross sales were $36.2 million for the full year, driven by continued momentum of the *Wisdom*™ snow goggle line and increased military sales.

Face Shields and Hockey Gloves

In June 1997, Oakley acquired One Xcel, Inc., a company that designed what the Company believed to be the only optically correct protective face shield available for use with hockey and football helmets. In 2001, the Company discontinued the One Xcel brand name for football shields and began marketing those products under the Oakley name. The Company transitioned its hockey shield products to the Oakley name in 2002 and also began marketing hockey gloves featuring the Oakley logo. Oakley continues to maintain a licensing relationship with the National Hockey League (NHL) for both of these product lines.

Product Line and Brand Extension

Oakley intends to introduce product line extensions and new product lines in the future and develop innovations targeted to attract additional consumers to its global brand. To take advantage of unique opportunities, the Company may, from time to time, manufacture private-label or other sunglasses for other companies. The Company may also market and sell sunglasses under brand names other than "Oakley." The Company may also consider acquisition opportunities that will enhance or complement the brand or add breadth to Oakley's product offerings. In addition, the Company has licensed, and may determine to further license, its intellectual property rights to others in optical or other industries.

Manufacturing

The Company's headquarters and principal manufacturing facility is located in Foothill Ranch, Orange County, California, where it assembles and produces most of its eyewear products. The Company uses state of the art manufacturing practices, such as cellular eyewear production, which allow for quick response to customer demand. The Company owns, operates and maintains most of the equipment used in manufacturing its eyewear products. In-house production can contribute significantly to gross profit margins and offers protection against piracy. It further enables the Company to produce products in accordance with its strict quality-control standards. Components and processes that are unlikely to add significant value are contracted to outside vendors. The Company utilizes third party manufacturers to produce its internally designed footwear, apparel, timepieces and certain goggles.

Much of the equipment used in the manufacture of Oakley products has been specially designed and adapted for the processes used by the Company. By manufacturing its own products, the Company has the opportunity to experiment with new materials and technologies which can lead to important discoveries, such as its patented *Iridium* ® coating technology (which the Company believes is one of the most sophisticated coating processes in the industry). Proprietary manufacturing equipment and methodologies are protected by special security measures employed at the Company's manufacturing facilities. The Company has a second manufacturing facility located in Dayton, Nevada, where it produces all of its *X-Metal* ® eyewear products.

In January 2001, the Company began surfacing prescription lenses at the Foothill Ranch, California facility with a prescription lens lab designed to achieve quick turnarounds, better quality control and higher optical standards. In June 2002, a second prescription lens manufacturing facility was opened in Ireland, which provides prescription lenses to Europe.

The Company has built strong relationships with its major suppliers. With most suppliers, it maintains agreements that prohibit disclosure of any of the Company's proprietary information or technology to third parties. Although the Company relies on outside suppliers for most of the specific molded components of its glasses, goggles, timepieces and footwear, the Company retains substantial ownership of all molds used in the production of the components. The Company believes that most components can be obtained from one or more alternative sources within a relatively short period of time. In addition, to further mitigate risk, the Company has developed an in-house injection molding capability for sunglass frames.

The Company relies on individual sources for the supply of several components, including the uncoated lens blanks from which virtually all of the Company's lenses are cut. In the event of the loss of the source for lens blanks, the Company has identified alternate sources that may be available. The effect of the loss of any of these sources (including any possible disruption in business) will depend primarily upon the length of time necessary to find a suitable alternative source and could have a material adverse effect on the Company's business. There can be no assurance that, if necessary, an additional source of supply for lens blanks can be located or developed in a timely manner.

In March 1997, the Company entered into a reciprocal exclusive dealing agreement with Gentex, its lens blank supplier, under which Oakley has the exclusive right to purchase, from such supplier, decentered sunglass lenses and a scratch-resistant coating developed for use with such lenses. In return, Oakley has agreed to purchase all of its decentered lens requirements, subject to certain exceptions, from such supplier. This agreement has been renewed and continues in force through March 2006. The Company's business interruption policy reimburses the Company for certain losses incurred by the Company as a result of an interruption in the supply of raw materials, including uncoated lens blanks, resulting from direct physical loss or damage to a supplier's premises. Subject to certain exceptions, the amount of coverage available for each affected supplier ranges from $3 million to $20 million. However, there can be no assurance that such policy will be sufficient to compensate the Company for all losses resulting from an interruption in the supply of raw materials.

Distribution

The Company sells Oakley eyewear in the United States through a carefully selected account base that fluctuates between 8,400 and 9,200 accounts, and 14,500 to 15,600 doors, depending on the seasonality of the Company's summer and winter products. The store base is comprised of optical stores, sunglass retailers and specialty sports stores, including bike, surf, snow and golf shops, and motorcycle, athletic footwear and sporting goods stores and department stores. Unlike many of its competitors, the Company has elected not to sell its current season products through discount stores, drug stores or traditional mail-order companies.

The Company's products are currently sold in over 100 countries outside the United States. In most of continental Europe, marketing and distribution are handled directly by the Company's subsidiary Oakley Europe, located in Paris, France, which is staffed by approximately 211 employees who perform sales, sports marketing, advertising, customer service, shipping and accounting functions. Since 1995, the Company has been selling Oakley products to Mexico and Central America on a direct basis through its subsidiary Oakley Mexico. In 1996, the Company acquired its exclusive distributor in the United Kingdom ("Oakley UK") and established an office in South Africa ("Oakley Africa") and began selling to those markets on a direct basis in the fourth quarter of 1996. In May 1997, the Company began selling to Japan ("Oakley Japan") on a direct basis through its own operation. In April 1998, the Company acquired the Oakley division of its exclusive Canadian distributor, enabling the Company to market and sell its products on a direct basis in Canada. In November 1999, the Company acquired its exclusive Australian distributor and thereby assumed direct responsibility for distribution of Oakley products in that market and in New Zealand. In June 2000, the Company assumed direct responsibility for distribution of Oakley products in the Austrian market and opened a new office known as Oakley GmbH in Munich, Germany to serve the German marketplace. In February 2002, the Company established an office in Brazil and began shipping products to retailers there in the third quarter of 2002.

In those parts of the world not serviced by the Company or its subsidiaries, Oakley products are sold through distributors who possess local expertise. These distributors sell the Company's products either exclusively or with complementary products. They agree to respect the marketing philosophy and practices of the Company and to receive extensive training regarding such philosophies and practices. For information regarding the Company's operations by geographic region, see Note 13 in *Notes to Consolidated Financial Statements* .

The Company requires its retailers and distributors to agree not to resell or divert Oakley products through unauthorized channels of distribution. Products shipped from Oakley's headquarters are marked with a tracking code that allows the Company to determine the source of diverted products sold by unauthorized retailers or distributors. When Oakley products are found at undesirable locations or unauthorized retailers, the Company purchases samples and, using the tracking device, determines the source of the diversion. The Company then estimates the potential damage to the Company's retail franchise and image and may require that the offending account repurchase the diverted product. In certain instances, the Company may terminate the account. When an existing account has been terminated, the Company may repurchase its own products from the retailer to protect the Oakley image and the exclusivity enjoyed by the Company's retail account base. The Company employs similar anti-diversion techniques in overseas markets.

In August 2001, the Company established the*Oakley Premium Dealer*program to identify and reward retailers that demonstrate superior support of the Oakley brand by, among other things, consistently maintaining a broad assortment of products and quickly embracing the Company's latest innovations. Retailers earning the *Oakley Premium Dealer* designation are eligible for cooperative marketing and advertising support, exclusive products, dealer locator prioritization on Oakley's website and favorable tagging in Oakley's annual print and outdoor advertising campaigns.

At December 31, 2003, the Company operated 86 department store concept shops throughout the country at retailers Dillards, Parisian, Macy's East, Macy's West, Marshall Fields and Carsons Pirie Scott. In addition to these locations, the company sells its footwear through Nordstrom and select Saks Fifth Avenue locations.

Advertising and Promotion

Oakley retains significant control over its promotional and advertising programs and believes it is able to deliver a more targeted consistent and well-recognized advertising message at substantial cost savings compared to complete reliance on outside agencies. The Company's print advertising consists of lifestyle, technical and athlete association campaigns highlighting its products.

While the Company uses traditional marketing methods in some instances, it attributes much of its success to the use of less conventional methods, including sports marketing, grassroots sports events, targeted product allocation and in-store display aids. The Company has used sports marketing extensively to achieve consistent, authentic exposure that equates to strong brand recognition on a global level. Oakley utilizes the exposure generated by its athletes as an "editorial" endorsement of product performance and style, as opposed to a commercial endorsement.

The sports marketing division consists of 23 sports marketing managers domestically, with an additional 30 managers positioned in direct offices and with distributors internationally. These experts specialize in multiple sport and entertainment market segments and niches. The mission of the Company's sports marketing experts is to identify and develop relationships with top athletes and opinion leaders in the sports and entertainment industry, negotiate their endorsement agreements and help them serve as ambassadors by educating them on the performance functions and benefits of Oakley products. This strategy has proven to gain editorial exposure that ultimately brings awareness and authenticity to the brand. The diverse knowledge of Oakley's sports marketing experts earns the respect of pro athletes especially in youth lifestyle sports such as surf, skate, motocross and snowboard, yet continues to successfully maintain leadership in more mainstream sports such as golf.

Another level of marketing is brand marketing. The Company will continue to support its products through targeted consumer efforts. Advertising will be leveraged to drive eyewear, footwear, apparel and watch sales and will be used to introduce consumers to the Company's other product categories. The 2004 campaign will include an integration of print media, outdoor media, in-mall billboards and point-of-sale displays.

Direct marketing programs will focus on*O Store*®, Iacon and Oakley Premium Dealers (OPD) and will overlay the base advertising plans used to engage consumers during key selling periods. These efforts are complemented by multiple brand catalogs, enhancements to the Company's website and Internet tie-ins. Public relations programs are designed to complement advertising campaigns and are centered on securing editorial exposure for new product inventions and technologies.

Internationally the Company retained BJK&E Media in London, England in 2001 to perform similar services for the Company's United Kingdom subsidiary. In 2002 the Company extended this relationship to include its German subsidiary. For the remainder of the Company's foreign offices, media services are retained in-house.

Retail Operations

At December 31, 2003, the Company operated 20 Oakley retail stores under the*O Store* name that offer a full range of Oakley products and feature marketing enhancements to support the brand. In addition to these full priced retail venues, the Company operated seven *Oakley Vaults*® , the Company's outlet store concept, featuring discontinued and excess seasonal merchandise in addition to newer products priced at full retail. The Company's retail stores comprise high profile locations positioned in some of the top malls throughout the country. The current roster includes stores located in the states of Florida, Texas, Colorado, California, Arizona, North Carolina, Hawaii, Minnesota, Nevada, Illinois and Virginia. The average size of each store is approximately 2,700 square feet. The Company prides itself on educating the retail staff with extensive product and sales knowledge that marries the quality of its inventions. For 2004, the Company intends to open a comparable number of stores that were opened in 2003.

On October 31, 2001, the Company completed the acquisition of Iacon, Inc. ("Iacon"), a sunglass retailing chain headquartered in Scottsdale, Arizona. Iacon operates a chain of mall-based sunglass specialty stores, using four separate retail concepts, under the names *Sunglass Designs* , *Sporting Eyes, Occhiali da Sole* and *Oakley Icon* located throughout the United States, with a concentration primarily in the sunbelt regions. Oakley is the leading brand sold in these multi-brand specialty sunglass boutiques. As of December 31, 2003, Iacon had 76 retail stores. The Company intends to expand these retail concepts across the United States.

In December 2003, the Company opened its first licensed *O Store®*,located in Santiago Chile, making it the sixth international Oakley retail location. In addition to this latest store opening, Oakley currently operates, through its South Pacific subsidiary, an *O Store®* in Torquay, Australia opened in November 2001 near the company's headquarters there; two Oakley *Vaults®* that opened under licensing agreements in March 2002 in Portsmouth and in April 2003 in York, United Kingdom; an Oakley *Vault®* that opened in December 2003 under license in Calais, France; and an Oakley *Vault®* opened in April 2002 that is operated by Oakley's South African subsidiary and is located near the company's South African headquarters there in Port Elizabeth, South Africa.

Internet Strategy and Systems

The Company continues to execute a comprehensive Internet channel strategy designed to allow more consumers to purchase Oakley products as efficiently as possible. The program utilizes the World Wide Web as a complementary channel to retail and international distributors. Ultimate goals include increased consumer awareness of the Oakley brand, improved customer service and increased sales through retail and E-commerce channels by harnessing the unique interactive capabilities of the Internet.

The Company's corporate Web site (*www.oakley.com)* is fully E-commerce capable. The site features a broad selection of Oakley eyewear, footwear, apparel, accessories and watches for delivery to U.S. and Canadian customers. The site also features a prominent dealer-locator function, including mapping, that directs consumers to local retailers and highlights *Oakley Premium Dealers* that showcase the widest selection of Oakley products.

The Company generated approximately $11.5 million of direct internet gross sales and associated telesales in 2003, an increase of $1.9 million, or 19.8 percent, over 2002.

The Company has implemented SAP's order processing, manufacturing, inventory management, distribution and finance modules in its key worldwide locations in the United States and most major international offices. This has created an efficient, streamlined supply-chain process capable of providing same-day or next-day shipping of in-stock orders.

Principal Customers

During 2003, net sales to the Company's largest ten customers, which included three international distributors, accounted for approximately 17.6% of the Company's total net sales. Net sales to one customer, Luxottica Group S.p.A. and its affiliates ("Luxottica")—owner of Sunglass Hut International, the largest sunglass specialty retailer in the world (referred to herein as "Sunglass Hut" or "Watch Station")—accounted for 9.0% of the Company's 2003 net sales.

Luxottica acquired Sunglass Hut in April 2001 and implemented changes which adversely affected the Company's net sales to Sunglass Hut in 2001. In December 2001, the Company and Luxottica entered into a new three-year commercial agreement for the distribution of Oakley products through Sunglass Hut retail stores which marked the resumption of the business relationship between the two companies after a short disruption that began in August 2001. The arrangements between the companies do not obligate Luxottica to order product from the Company, and there can be no assurances as to the future of the relationship between the Company and Luxottica. In September 2003, Luxottica completed the acquisition of all the shares of Australian eyewear retailer OPSM Group Ltd ("OPSM"). OPSM operates in the South Pacific and Southeast Asia regions with approximately 600 retail locations, a portion of which currently offer some of the Company's products. For 2003, the Company's net sales to OPSM prior to the acquisition were approximately AUD $1.1 million (or approximately $0.7 million in U.S. dollars based on the average exchange rate for 2003). For 2002, the Company's net sales to OPSM were approximately AUD $2.8 million (or approximately $1.5 million in U.S. dollars based on the average exchange rate for 2002). These sales exclude a limited amount of sales generated through the Company's international distributors. In November 2003, Luxottica completed the acquisition of New Zealand eyewear retailer Sunglass Store New Zealand ("SSNZ"), the Company's largest customer in New Zealand. SSNZ operates in New Zealand with 16 retail locations which offer some of the Company's products. In January 2004, Luxottica entered into a definitive merger agreement with Cole National Corporation ("Cole"), one of the largest optical retailers and largest chain providers of managed vision care services worldwide. This merger is expected to close in the second half of 2004 pending the approval of Cole's stockholders and its compliance with applicable antitrust requirements. The Company currently sells to a small portion of Cole's retail locations and sales to the customer have been immaterial. There can be no assurance that the recent acquisitions or future acquisitions by Luxottica will not have a material adverse impact on the Company's financial position or results of operations.

Intellectual Property

The Company aggressively asserts its rights under patent, trade secret, unfair competition, trademark and copyright laws to protect its intellectual property, including product designs, proprietary manufacturing processes and technologies, product research and concepts and recognized trademarks. These rights are protected through patents and trademark registrations, the maintenance of trade secrets, the development of trade dress, and where appropriate, litigation against those who are, in the Company's opinion, infringing these rights. The Company has filed suit against a number of its competitors to enforce certain of the Company's patents and trademarks. While there are no guarantees in a litigation setting, the Company's legal team aggressively seeks to protect the Company's patents and trademarks in an attempt to fully protect the Company's proprietary information and technologies. The Company intends to continue asserting its intellectual property rights against infringers. The Company has developed a reputation in the sunglass industry as a vigorous defender of its intellectual property rights; this reputation acts as a deterrent against the introduction of potentially infringing products by its competitors and others.

The following table reflects data as of December 31, 2003 concerning the Company's intellectual property:

	Number of Utility/Design Patents		Number of Trademarks	
	Issued	**Pending**	**Issued**	**Pending**
United States	172	20	144	30
International	373	109	832	210

Over the next four years, 23 U.S. patents and 47 international patents that the Company currently holds will expire, including the Company's Toroidal Lens (POLARIC ELLIPSOID™) patent. Although the Company may continue to use the technology underlying some of these patents, the expiration of these patents is not expected to have a material impact on the Company for a variety of reasons, including that many of the patents relate to the design or production of products that are either no longer produced by the Company or do not represent a significant portion of the Company's revenues. In the case of the Toroidal Lens (POLARIC ELLIPSOID™) patent, advancements in optical properties arising from the Company's XYZ Optics® patents, the Company's dominant position in the sports eyewear segment and the adoption of alternative lens geometries by the Company's competitors reduce the likelihood of any negative financial consequences from the expiration of this patent. In addition, the Company utilizes other proprietary technologies and precision manufacturing processes in the production of its products which also reduce the risks associated with the expiration of the Company's patents. The remainder of the Company's patents will expire on dates from 2008 and after.

The Company dissuades counterfeiting through the active monitoring of the marketplace by its anti-counterfeiting personnel and other employees and through the services provided by outside firms that specialize in anti-counterfeiting measures. The Company's sales representatives, distributors and retailers have also proved to be effective watchdogs against infringing products, frequently notifying the Company of any suspicious products and assisting law enforcement agencies. The Company's sales representatives are educated on Oakley's patents and trade dress, and assist in preventing infringers from obtaining retail shelf space.

Competition

The Company is a leading designer, manufacturer and distributor of eyewear in the sports segment of the nonprescription eyewear market. Within this segment, the Company competes with mostly smaller sunglass and goggle companies in various niches of the sports market and a limited number of larger competitors, some of whom have greater financial and other resources than the Company. Some of these niche markets are susceptible to rapid changes in consumer preferences, which could affect acceptance of the Company's products. Oakley believes the vigorous protection of its intellectual property rights has limited the ability of others to compete in this segment. Accordingly, the Company believes that it is the established leader in this segment of the market, although several companies, including Luxottica, Marchon, Safilo and various smaller niche brands, compete with the Company for shelf space.

The Company also competes in the broader non-sports, or recreational, segment of the sunglass market, which is fragmented and highly competitive. The major competitive factors include fashion trends, brand recognition, marketing strategies, distribution channels and the number and range of products offered. A number of established companies, including Luxottica, compete in this wider market. In order to retain its market share, the Company must continue to be competitive in quality and performance, technology, method of distribution, style, brand image, intellectual property protection and customer service. In April 2001, Luxottica acquired Sunglass Hut, the Company's largest customer. See "Principal Customers."

The Company-owned Iacon chain of specialty sunglass stores competes primarily with mall-based sunglass specialty retailers, the largest being Sunglass Hut, which is owned by competitor Luxottica.

Within the athletic footwear market, the Company competes with large, established brands such as Nike, FootJoy, Reebok, Adidas and Timberland, among others which have greater financial and other resources than the Company. In addition to these dominant brands, the Company also competes with smaller niche brands, such as Vans, Reef and Teva, among others. The Company's technical apparel outerwear competes primarily with Burton, North Face, Columbia Sportswear and Patagonia. The Company's sports and lifestyle apparel competes primarily with Nike, Quiksilver, Billabong, Ashworth and various smaller niche brands.

The Company's luxury timepiece products compete in the upper-middle and luxury segments of the watch market (respectively categorized by the retail price points $300-$900 and $1,000 plus) which is dominated by established Swiss brands, including Rolex, Breitling, Omega, TAG-Heuer, Movado, Rado and Hamilton. The Company's performance watches compete in the middle segment of the watch market which is characterized by sports watches from Nike, Adidas, Timex and Casio. In addition, the Company's performance watches compete with other fashion brands from the Swatch Group, Swiss Army and Fossil with retail price points of $50-$299.

Domestic and Foreign Operations

See Note 13 in *Notes to the Consolidated Financial Statements* for discussion regarding domestic and foreign operations.

Employees

The Company believes that its employees are among its most valuable resources and have been a key factor in the success of Oakley's products. As of December 31, 2003, the total count of worldwide full-time regular employees was 2,456. In addition, the Company may utilize as many as 500 temporary personnel from time to time, especially during peak summer months.

The Company is not a party to any labor agreements and none of its employees is represented by a labor union. The Company considers its relationship with its employees to be good and has never experienced a work stoppage.

Item 2. Properties

The Company's principal corporate and manufacturing facility is located in Foothill Ranch, Orange County, California. The facility, which is owned by the Company, is approximately 500,000 square feet, with potential to expand into an additional 100,000 square feet. In June 1996, the Company purchased a facility in Nevada of approximately 63,000 square feet for the production of its *X Metal®* eyewear. In addition, the Company leases office and warehouse space as necessary to support its operations worldwide, including offices in the United Kingdom, Germany, France, Italy, Australia, South Africa, Japan, Canada, New Zealand, Brazil and the state of Washington. The Company owns a business office and warehouse of approximately 18,000 square feet in Mexico City for its operations in Mexico and Central America. The facility was first occupied in late 1998. Since late 2000, the Company has leased approximately 150,000 square feet of space in Ontario, California to support the expanding distribution needs of its footwear and apparel lines. The new facility began shipping the Company's spring footwear and apparel lines to retailers in early 2001. In June 2002, a third manufacturing facility which provides prescription lenses to Europe was opened in Ireland. In 2003, the Company established a centralized footwear and apparel third-party warehouse arrangement in the Netherlands. The Company believes its current and planned facilities are adequate to carry on its business as currently contemplated.

The Company is subject to federal, state and local environmental laws, regulations and ordinances that (i) govern activities or operations that may have adverse environmental effects (such as emissions to air, discharges to water, and the generation, handling, storage and disposal of solid and hazardous wastes) or (ii) impose liability for the cost of cleanup or other remediation of contaminated property, including damages from spills, disposals or other releases of hazardous substances or wastes, in certain circumstances without regard to fault. The Company's manufacturing operations routinely involve the handling of chemicals and wastes, some of which are or may become regulated as hazardous substances. The Company has not incurred, and does not expect to incur, any significant expenditures or liabilities for environmental matters. As a result, the Company believes that its environmental obligations will not have a material adverse effect on its operations or financial position.

Item 3. Legal Proceedings

The Company is a party to various claims, complaints and other legal actions that have arisen in the normal course of business from time to time. The Company believes the outcome of these pending legal proceedings, in the aggregate, is not likely to have a material adverse effect on the operations or financial position of the Company.

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

None.

Part II

Item 5. Market for Registrant's Common Equity and Related Shareholder Matters

The Company's common stock, par value $.01 per share ("Common Stock"), began trading on the New York Stock Exchange on August 10, 1995 upon completion of the Company's initial public offering (trading symbol "OO"). As of March 8, 2004, the closing sales price for the Common Stock was $15.45. The following table sets forth the high and low sales prices for the Common Stock for each quarter of 2003 and 2002 on the New York Stock Exchange Composite Tape:

	High	Low
2003		
First Quarter	$ 10.62	$ 7.37
Second Quarter	$ 12.13	$ 7.81
Third Quarter	$ 12.28	$ 10.00
Fourth Quarter	$ 14.10	$ 10.11
2002		
First Quarter	$ 18.95	$ 14.32
Second Quarter	$ 19.99	$ 17.10
Third Quarter	$ 16.57	$ 9.70
Fourth Quarter	$ 13.93	$ 9.13

The number of shareholders of record of the Company's Common Stock on March 8, 2004 was 501.

Dividend Policy

On August 12, 2003, the Company's Board of Directors announced the initiation of an annual dividend policy and declared an initial annual cash dividend of $0.14 per share. This dividend, totaling $9.5 million, was paid on October 31, 2003 to shareholders of record as of the close of business on October 15, 2003. Any future dividends are at the discretion, and subject to the approval, of the Company's Board of Directors and will depend upon the Company's results of operations, financial condition, contractual restrictions and other factors deemed relevant by the Board of Directors.

Securities Authorized for Issuance Under Equity Compensation Plans

Securities authorized for issuance under the Company's equity compensation plans are as follows:

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	4,808,020	$12.14	2,095,398
Equity compensation plans not approved by security holders	Not applicable	Not applicable	Not applicable

Item 6. Selected Financial Data

The following table sets forth certain selected financial data regarding the Company which is qualified by reference to, and should be read in conjunction with, the Consolidated Financial Statements and Notes thereto. See *Index to Consolidated Financial Statements* and *Item 7. Management's*

Discussion and Analysis of Financial Condition and Results of Operations. The income statement data and balance sheet data presented below have been derived from the Company's consolidated financial statements. The Company's consolidated income statements for the fiscal years ended December 31, 2003, 2002 and 2001 and consolidated balance sheets as of December 31, 2003 and 2002 included herein have been audited by Deloitte & Touche LLP, the Company's independent auditors, as indicated in their report included elsewhere herein. The selected income statement data set forth herein are for informational purposes only and may not necessarily be indicative of the Company's future results of operations.

	Year Ended December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
	(dollars in thousands, except share and per share data)				
Income Statement Data:					
Net sales	$ 521,549	$ 489,552	$ 429,267	$ 363,474	$ 257,872
Cost of goods sold	226,846	211,962	174,332	138,408	109,338
Gross profit	294,703	277,590	254,935	225,066	148,534
Operating expenses:					
Research and development	14,308	16,016	11,318	7,894	6,304
Selling	142,365	126,995	108,948	90,291	72,184
Shipping and warehousing	19,077	18,083	16,997	10,005	6,592
General and administrative	58,918	52,335	43,606	35,612	30,977
Total operating expenses	234,668	213,429	180,869	143,802	116,057
Operating income	60,035	64,161	74,066	81,264	32,477
Interest expense, net	1,272	1,643	3,108	2,723	1,951
Income before provision for income taxes	58,763	62,518	70,958	78,541	30,526
Provision for income taxes	20,567	21,881	20,587	27,489	10,684
Net income	$ 38,196	$ 40,637	$ 50,371	$ 51,052	$ 19,842
Basic net income per share	$ 0.56	$ 0.59	$ 0.73	$ 0.74	$ 0.28
Basic weighted average common shares	68,006,000	68,732,000	68,856,000	69,041,000	70,660,000
Diluted net income per share	$ 0.56	$ 0.59	$ 0.72	$ 0.73	$ 0.28
Diluted weighted average common shares	68,282,000	69,333,000	69,751,000	69,709,000	70,662,000
Dividend per share	$ 0.14	$ —	$ —	$ —	$ —

	At December31,				
	2003	**2002**	**2001**	**2000**	**1999**
Balance Sheet Data:					
Working capital	$ 154,532	$ 129,008	$ 106,318	$ 84,176	$ 59,247
Total assets	434,884	383,950	362,780	302,986	239,350
Total debt	28,700	30,757	59,042	35,746	25,060
Shareholders' equity	326,604	293,831	260,710	208,173	177,837

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion includes the operations of Oakley, Inc. and its subsidiaries for each of the periods discussed.

Overview

Oakley is an innovation-driven designer, manufacturer and distributor of consumer products that include high-performance eyewear, footwear, watches, apparel and accessories. The Company's products are sold in the United States through a carefully selected base of accounts which fluctuates between 8,400 and 9,200 with approximately 14,500 to 15,600 locations depending on seasonality of summer and winter products. The store base is comprised of optical stores, sunglass retailers and specialty sports stores, including bike, surf, snow and golf shops, and motorcycle, athletic footwear and sporting goods stores and limited department store distribution. The Company also operates 27 Oakley retail stores in the United States that offer a full range of Oakley products. Additionally, the Company owns Iacon, Inc., a sunglass retailing chain headquartered in Scottsdale, Arizona, with 76 sunglass specialty retail stores at December 31, 2003.

Internationally, the Company sells its products in over 100 countries outside the United States, with direct offices in France, Germany, United Kingdom, Italy, Japan, Mexico, South Africa, Canada, Australia, New Zealand and Brazil. In those parts of the world not serviced by the Company or its subsidiaries, Oakley products are sold through distributors who possess local expertise. These distributors sell the Company's products either exclusively or with complementary products and agree to respect the marketing philosophy and practices of the Company. Sales to the Company's distributors are denominated in U.S. dollars. The Company is exposed to gains and losses resulting from fluctuations in foreign currency exchange rates relating to transactions of its international subsidiaries. The Company and its subsidiaries use foreign exchange contracts in the form of forward contracts to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates .

Significant Accounting Policies and Certain Risks and Uncertainties

The Company's historical success is attributable, in part, to its introduction of products which are perceived to represent an improvement in performance over products available in the market. The Company's future success will depend, in part, upon its continued ability to develop and introduce such innovative products, although there can be no assurance of the Company's ability to do so. The consumer products industry, including the eyewear, apparel, footwear and watch categories, is fragmented and highly competitive. In order to retain its market share, the Company must continue to be competitive in the areas of quality, technology, method of distribution, style, brand image, intellectual property protection and customer service. These industries are subject to changing consumer preferences and shifts in consumer preferences may adversely affect companies that misjudge such preferences.

The Company's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. As such, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the balance sheet dates and the reported amounts of revenue and expense during the reporting periods. Actual results could significantly differ from such estimates. The Company believes that the following discussion addresses the Company's most significant accounting policies, which are the most critical to aid in fully understanding and evaluating the Company's reported financial results.

Revenue Recognition

The Company recognizes wholesale revenue when merchandise is shipped to a customer and the risks and rewards of ownership have passed based on the terms of sale. Revenue from the Company's retail store operations is recognized upon purchase by customers at the point of sale. Generally, the Company extends credit to its wholesale customers and does not require collateral. The Company performs ongoing credit evaluations of those customers and historic credit losses have been within management's expectations. Sales agreements with dealers and distributors normally provide general payment terms of 30 to 120 days, depending on the product category. The Company's standard sales agreements with its customers do not provide for any rights of return by the customer other than returns for product warranty related issues. In addition to these product warranty related returns, the Company occasionally accepts other returns at its discretion. The Company records a provision for sales returns and claims based upon historical experience. Actual returns and claims in any future period may differ from the Company's estimates.

Accounts Receivable

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current creditworthiness, as determined by the Company's review of their current credit information. The Company regularly monitors its customer collections and payments and maintains a provision for estimated credit losses based upon the Company's historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within the expectations and the provisions established by the Company, there can be no assurances that the Company will continue to experience the same credit loss rates that have been experienced in the past.

Inventories

Inventories are stated at the lower of cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. The Company regularly reviews its inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on the Company's estimated forecast of product demand and production requirements. Demand for the Company's products can fluctuate significantly. Factors which could affect demand for the Company's products include unanticipated changes in general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by retailers; continued weakening of economic conditions, which could reduce demand for products sold by the Company and which could adversely affect profitability; and future terrorist acts or war, or the threat or escalation thereof, which could adversely affect consumer confidence and spending, interrupt production and distribution of product and raw materials and, as a result, adversely affect the Company's operations and financial performance. Additionally, management's estimates of future product demand may be inaccurate, which could result in an understated or overstated provision required for excess and obsolete inventory.

Long-Lived Assets

In the normal course of business, the Company acquires tangible and intangible assets. The Company periodically evaluates the recoverability of the carrying amount of its long-lived assets (including property, plant and equipment, and other intangible assets) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable. An impairment is assessed when the undiscounted expected future cash flows derived from an asset are less than its carrying amount. Impairments are recognized in operating earnings. The Company uses its best judgment based on the most current facts and circumstances surrounding its business when applying these impairment rules to determine the timing of the impairment test, the undiscounted cash flows used to assess impairments and the fair value of a potentially impaired asset. Changes in assumptions used could have a significant impact on the Company's assessment of recoverability. Numerous factors, including changes in the Company's business, industry segment or the global economy could significantly impact management's decision to retain, dispose of or idle certain of its long-lived assets.

Goodwill

The Company evaluates 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 determined based on estimated future cash flows, discounted at a rate that approximates the Company's cost of capital. Such estimates are subject to change and the Company may be required to recognize impairment losses in the future.

Warranties

The Company provides a one-year limited warranty against manufacturer's defects in its eyewear. All authentic Oakley watches are warranted for one year against manufacturer's defects when purchased from an authorized Oakley watch dealer. Footwear is warranted for 90 days against manufacturer's defects, and apparel is warranted for 30 days against manufacturer's defects. The Company's standard warranties require the Company to repair or replace defective product returned to the Company during such warranty period. The Company maintains a reserve for its product warranty liability based on estimates calculated using historical warranty experience. While warranty costs have historically been within the Company's expectations, there can be no assurance that the Company will continue to experience the same warranty return rates or repair costs as in the prior years. A significant increase in product return rates, or a significant increase in the costs to repair product, could have a material adverse impact on the Company's operating results.

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. The Company considers future taxable income and ongoing, prudent and feasible tax planning strategies in assessing the value of its deferred tax assets. If the Company determines that it is more likely than not that these assets will not be realized, the Company will 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 the Company's judgment. If the Company subsequently determined that the deferred tax assets, which had been written down, would 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. See Note 7 in *Notes to Consolidated Financial Statements.*

Insurance Coverage

The Company is partially self-insured for its workers' compensation insurance coverage. Under this insurance program, the Company is liable for a deductible of $250,000 for each individual claim and an aggregate annual liability of $1,368,000. The Company records a liability for the estimated cost of claims both reported and incurred but not reported based upon its historical experience. The estimated costs include the estimated future cost of all open claims. The Company will continue to adjust the estimates as the actual experience dictates. A significant change in the number or dollar amount of claims could cause the Company to revise its estimate of potential losses and affect its reported results.

Foreign Currency Translation

The Company has direct operations in Continental Europe, United Kingdom, Japan, Canada, Mexico, South Africa, Australia, New Zealand and Brazil which collect at future dates in the customers' local currencies and purchase finished goods in U.S. dollars. Accordingly, the Company is exposed to transaction gains and losses that could result from changes in foreign currency. Assets and liabilities of the Company 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 (loss). Gains and losses on short-term intercompany foreign currency transactions are recognized as incurred. As part of the Company's overall strategy to manage its level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company and its subsidiaries have entered into various foreign exchange contracts in the form of forward contracts. See Note 10 in *Notes to Consolidated Financial Statements.*

Vulnerability Due to Supplier Concentrations

The Company relies on a single source for the supply of several product components, including the uncoated lens blanks from which substantially all of its sunglass lenses are cut. In the event of the loss of its source for lens blanks, the Company has identified an alternate source which may be available. The effect of the loss of any of these sources (including any possible disruption in business) will depend primarily upon the length of time necessary to find a suitable alternative source and could have a material adverse effect on the Company's business. There can be no assurance that, if necessary, an additional source of supply for lens blanks or other critical materials can be located or developed in a timely manner.

Vulnerability Due to Customer Concentrations

Net sales to the retail group of Luxottica S.p.A ("Luxottica"), which include Sunglass Hut locations worldwide, were approximately 9.0%, 12.2% and 12.0% of the Company's net sales for the years ended December 31, 2003, 2002 and 2001, respectively. Luxottica is also one of the Company's largest competitors in the sunglass and optical frame markets. Luxottica acquired Sunglass Hut in April 2001 and implemented changes which adversely affected the Company's net sales to Sunglass Hut in 2001. In December 2001, the Company and Luxottica entered into a new three-year commercial agreement for the distribution of Oakley products through Sunglass Hut retail stores which marked the resumption of the business relationship between the two companies after a short disruption that began in August 2001. The arrangements between the companies do not obligate Luxottica to order product from the Company, and there can be no assurances as to the future of the relationship between the Company and Luxottica. In September 2003, Luxottica completed the acquisition of all the shares of Australian eyewear retailer OPSM Group Ltd ("OPSM"). OPSM operates in the South Pacific and Southeast Asia regions with approximately 600 retail locations, a portion of which currently offer some of the Company's products. For 2003, the Company's net sales to OPSM prior to the acquisition were approximately AUD $1.1 million (or approximately $0.7 million in U.S. dollars based on the average exchange rate for 2003). For 2002, the Company's net sales to OPSM were approximately AUD $2.8 million (or approximately $1.5 million in U.S. dollars based on the average exchange rate for 2002). These sales exclude a limited amount of sales generated through the Company's international distributors. In November 2003, Luxottica completed the acquisition of New Zealand eyewear retailer Sunglass Store New Zealand ("SSNZ"), the Company's largest customer in New Zealand. SSNZ operates in New Zealand with 16 retail locations which offer some of the Company's products. In January 2004, Luxottica entered into a definitive merger agreement with Cole National Corporation ("Cole"), one of the largest optical retailers and largest chain providers of managed vision care services worldwide. This merger is expected to close in the second half of 2004 pending the approval of Cole's stockholders and its compliance with applicable antitrust requirements. The Company currently sells to a small portion of Cole's retail locations and sales to this customer have been immaterial. There can be no assurance that the recent acquisitions or future acquisitions by Luxottica will not have a material adverse impact on the Company's financial position or results of operations.

Commitments and Contingencies

The Company has entered into operating leases, primarily for facilities and retail stores, and has commitments under endorsement contracts with selected athletes and others who endorse the Company's products. Minimum future payments under these leases and endorsement contracts are identified in Note 9 in *Notes to Consolidated Financial Statements* .

Restructure Charge

A restructure charge of $2.8 million ($1.8 million, or $0.02 per diluted share, on an after-tax basis) was recorded during the fourth quarter of fiscal 2002 to restructure (the "Restructuring Plan") the Company's European operations with significant changes to the regional sales and distribution organization. Pursuant to an approval of the Company's Board of Directors in December 2002, relationships with several outside sales agents have been modified or terminated, and changes have been implemented to rationalize other warehousing and distribution functions within the European markets. During 2003, the Company paid or settled almost all of the expenses associated with the Restructuring Plan. As of December 31, 2003, the Company had finalized all the restructuring charges and management believes the amount originally recorded will be sufficient to cover any remaining restructure liabilities. See Note 14 in *Notes to Consolidated Financial Statements* .

This charge is included in selling and shipping and warehousing expenses and is comprised of the following components:

	Accrued restructure liability balance at Dec. 31, 2002	Amounts paid	Changes due to foreign exchange rates and adjustments	Balance as of Dec. 31, 2003
Termination and modification of sales agent contracts and employee contracts	$ 2,249	$ (1,960)	$ (31)	$ 258
Rationalization of warehousing and distribution	539	(864)	325	—
	$ 2,788	$ (2,824)	$ 294	$ 258

Results of Operations

The following tables set forth operating results in dollars and as a percentage of net sales for the periods indicated.

OAKLEY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(dollars in thousands)

	Year Ended December 31,		
	2003	**2002**	**2001**
Net sales	$ 521,549	$ 489,552	$ 429,267
Cost of goods sold	226,846	211,962	174,332
Gross profit	294,703	277,590	254,935
Operating expenses:			
Research and development	14,308	16,016	11,318
Selling	142,365	126,995	108,948
Shipping and warehousing	19,077	18,083	16,997
General and administrative	58,918	52,335	43,606
Total operating expenses	234,668	213,429	180,869
Operating income	60,035	64,161	74,066
Interest expense, net	1,272	1,643	3,108
Income before provision for income taxes	58,763	62,518	70,958
Provision for income taxes	20,567	21,881	20,587
Net income	$ 38,196	$ 40,637	$ 50,371

	Year Ended December 31,		
	2003	**2002**	**2001**
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	43.5	43.3	40.6
Gross profit	56.5	56.7	59.4
Operating expenses:			
Research and development	2.7	3.3	2.5
Selling	27.3	25.9	25.4
Shipping and warehousing	3.7	3.7	4.0
General and administrative	11.3	10.7	10.2
Total operating expenses	45.0	43.6	42.1
Operating income	11.5	13.1	17.3
Interest expense, net	0.2	0.3	0.8
Income before provision for income taxes	11.3	12.8	16.5
Provision for income taxes	4.0	4.5	4.8
Net income	7.3%	8.3%	11.7%

The Company's gross sunglass sales, before discounts and defective returns, were $310.4 million, $330.2 million and $301.6 million for the years ended December 31, 2003, 2002 and 2001, respectively. Sunglass unit sales were 4,199,916; 4,707,822; and 4,721,387 for the years ended December 31, 2003, 2002 and 2001, respectively.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Net sales

Net sales increased to $521.5 million for the year ended December 31, 2003 from $489.6 million for the year ended December 31, 2002, an increase of $31.9 million, or 6.5%. Gross sales were $560.6 million in 2003 compared to $528.8 million for 2002. Gross sunglass sales decreased $19.8 million to $310.4 million for the year ended December 31, 2003 compared to $330.2 million for the year ended December 31, 2002. Sunglass unit shipments declined 10.8% due to a number of adverse factors including weak consumer spending related in part to the events in Iraq during the first part of the year, a reduction in sales contribution from new sunglass introductions, wet weather patterns in key markets during the peak sunglass selling season and competitive pressures from strong fashion brands in the southern European markets. The decrease in sunglass unit shipments was partially offset by a 5.4% increase in average selling price primarily as a result of favorable foreign exchange rates and a greater contribution from the Company's retail store operations. The Company experienced declines in sales of more mature products, which were partially offset by increased sales from the *Half Jacket*™ , *Half Wire*™ and *Splice* ®, introduced in 2002, as well as sales of the Company's new 2003 sunglass styles including the *Valve*™, *Big Square Wire*®, *Monster Dog*™ and *Teaspoon*™ . In addition, the Company experienced increased sales of the Company's polarized styles for 2003. Gross sales from the Company's newer product categories, comprised of footwear, apparel, watches and prescription eyewear, increased 23.5%, or $31.4 million, to $165.1 million for 2003 from $133.7 million for 2002. As a percentage of gross sales, these new product categories accounted for 29.5% of total gross sales for 2003 compared to 25.3% for 2002. The strongest results were from the apparel and prescription eyewear categories where strong line introductions drove sales increases. Gross sales of the Company's goggles increased 30.2%, driven by the success of *Wisdom*™ , the Company's most advanced snow goggle, introduced in the fourth quarter of 2002. While gross sales of the Company's footwear increased 17.0%, or $5.3 million, to $36.5 million for 2003 from $31.2 million for 2002, the Company experienced poor sell-through of its fall line of footwear products which the Company believes could have an adverse effect on its 2004 footwear business. Management believes these sales increases are a result of its expanded product lines, expanded distribution and retail initiatives, including its greater dealer base and increasing consumer acceptance of the Company's newer categories.

The Company's U.S. net sales, excluding retail store operations, decreased 7.9% for the year ended December 31, 2003 to $203.8 million from $221.4 million in 2002 as a result of a 26.2% decrease in sales to the Company's largest U.S. customer, Sunglass Hut and its affiliates, coupled with a 2.6% decrease in net sales to the Company's broad specialty store account base and other domestic sales. Sales to Sunglass Hut decreased $13.2 million to $37.1 million for the year ended December 31, 2003 from $50.3 million for the year ended December 31, 2002. The decline in U.S. net sales reflects the generally depressed retail environment during the first half of 2003, which had a more pronounced effect on the Company's mature sunglass category and contributed to the decline in sunglass sales. Additionally, unusual cooler weather conditions during the second quarter of 2003 adversely affected the Company's summer product sales, particularly sunglasses, sandals, the summer apparel line and the Company's prescription sunglasses which led to lower than expected U.S. sales. The decrease in the Company's U.S. sales was partially offset by a higher contribution from its retail store operations. In addition, the Company's U.S. net sales in 2003 benefited from strong growth in military sales and increased department store concept shop locations over 2002.

Net sales from the Company's retail store operations increased to $53.2 million for the year ended December 31, 2003 as a result of increased store locations, compared to $32.6 million for the year ended December 31, 2002, an increase of $20.6 million, or 63.2%. During 2003, the Company opened 13 new Oakley stores and 17 Iacon stores, including the acquisition of *Celebrity Eyeworks Studio* located at Downtown Disney in Orlando, Florida. At December 31, 2003, the Company operated 27 Oakley stores and 76 Iacon stores.

During the year ended December 31, 2003, the Company's international net sales increased 12.3%, or $29.0 million, to $264.5 million from $235.5 million for 2002. The weaker U.S. dollar accounted for 11.3 percentage points, or $26.5 million, of this increase. All product categories experienced growth with the largest growth occurring in apparel and prescription eyewear. Europe, Latin America, Japan, Canada and South Africa each achieved growth, partially offset by declines in the rest of Asia where concerns related to the SARS crisis affected travel and related retail businesses during the first part of 2003 and the Company's transition to new distribution adversely impacted sales in the fourth quarter. The Company's sales in Australia declined on a constant dollar basis in the fourth quarter of 2003 and the total year. These declines were due primarily to disruptions associated with Luxottica's acquisition of OPSM in Australia along with declining market share in the surf distribution channel. In addition, the Company's 2003 European sunglass sales were impacted by competitive pressures from strong fashion brands. Latin America experienced a large decrease in net sales in the 2002 period due to delays in the transition to direct distribution in Brazil from the previous independent distributor and overall weak economic conditions in the region. Sales from the Company's direct international offices represented 87.9% of total international sales for 2003, compared to 84.9% for 2002.

Gross profit

Gross profit increased to $294.7 million, or 56.5% of net sales, for the year ended December 31, 2003 from $277.6 million, or 56.7% of net sales, for the year ended December 31, 2002, an increase of $17.1 million, or 6.2%. The decrease in gross profit as a percent of net sales was due to lower sunglass margins due to the decline in sunglass unit volume, partially offset by the positive effects of improved footwear and apparel margins and the positive effect of a weaker U.S. dollar.

Operating expenses

A restructure charge of $2.8 million ($1.8 million, or $0.02 per diluted share, on an after-tax basis) was recorded during the fourth quarter of fiscal 2002 to restructure the Company's European operations with significant changes made to the regional sales and distribution organization. This charge, included in selling and shipping and warehousing expenses, was completed during the fourth quarter of 2003 with no revisions to the original charge recorded. See Note 14 in *Notes to Consolidated Financial Statements* . Operating expenses for the year ended December 31, 2003 increased to $234.7 million from $213.4 million for the year ended December 31, 2002, an increase of $21.3 million, or 10.0%. As a percentage of net sales, operating expenses increased to 45.0% of net sales for the year ended December 31, 2003 compared to 43.6% of net sales for 2002. Excluding the $2.8 million European restructuring charge recorded in 2002, operating expenses increased to $234.7 million, or 45.0% of net sales, for the year ended December 31, 2003 from $210.6 million, or 43.0% of net sales, for the year ended December 31, 2002, an increase of $24.1 million, or 11.4%. The increase is primarily due to higher foreign operating expenses resulting from a weaker U.S. dollar and higher selling expenses related to the Company's expanded retail store operations. The weakening of the U.S. dollar, compared to most other currencies in which the Company transacts, contributed approximately $10.4 million, or 43.2%, of the increase. Operating expenses included $19.2 million of expenses for the Company's retail store operations, an increase of $6.9 million from $12.3 million for the year ended December 31, 2002. Total increase in retail store operating expenses for 2003 represented 28.6% of the increase in total operating expenses over 2002 due to the increased store locations.

Research and development expenses decreased $1.7 million to $14.3 million, or 2.7% of net sales, for the year ended December 31, 2003, from $16.0 million, or 3.3% of net sales, for the year ended December 31, 2002, primarily due to leverage on footwear and apparel design expenses and reduced product design expenses in 2003. Selling expenses increased $15.4 million to $142.4 million, or 27.3% of net sales, for the year ended December 31, 2003 from $127.0 million, or 25.9% of net sales, for the year ended December 31, 2002. Excluding $2.3 million relating to the European restructuring charge, selling expenses were $142.4 million for the year ended December 31, 2003, compared to $124.7 million for the year ended December 31, 2002, an increase of $17.7 million. This increase was a result of increased retail selling expenses, including sales personnel expenses, displays and display depreciation, sports marketing, sales promotion and sales commissions. As a percentage of net sales, selling expenses excluding the restructure charge was 27.3% in 2003 compared to 25.5% for 2002. Shipping and warehousing expenses as a percentage of net sales remained at 3.7% of net sales for the year ended December 31, 2003 and 2002. Excluding $0.5 million related to the 2002 European restructuring charge, shipping and warehousing expenses as a percentage of sales increased to 3.7% of net sales in 2003 from 3.6% of net sales in 2002 due to increased freight costs and footwear and apparel distribution costs, including the establishment of the Company's centralized European distribution facility in 2003. General and administrative expenses increased $6.6 million to $58.9 million, or 11.3% of net sales, for the year ended December 31, 2003, from $52.3 million, or 10.7% of net sales, for the year ended December 31, 2002. This increase in general and administrative expenses was principally a result of greater personnel-related costs, greater facility related costs, such as property taxes and insurance, depreciation, professional fees associated with tax audit support and the Company's Sarbanes-Oxley compliance, increases in provision for non-income taxes, as well as increased general and administrative expenses for retail store operations.

Operating income

The Company's operating income decreased to $60.0 million, or 11.5% of net sales, for the year ended December 31, 2003 from $64.2 million, or 13.1% of net sales, a decrease of $4.2 million. Excluding the European restructuring charge of $2.8 million in 2002, the Company's operating income decreased $7.0 million to $60.0 million for the year ended December 31, 2003 from $67.0 million for the year ended December 31, 2002. As a percentage of net sales, operating income, prior to the restructure charge, decreased to 11.5% for the year ended December 31, 2003 from 13.7% for the year ended December 31, 2002. For 2003, the net effect on operating income from foreign exchange was significantly positive as the beneficial effect on international sales from the weakening dollar more than offset the growth in international operating expenses and cost of goods sold items from stronger foreign currencies as well as losses on foreign exchange contracts, except in limited cases when the Company reduced pricing in foreign currencies.

Interest expense, net

The Company had net interest expense of $1.3 million for the year ended December 31, 2003, as compared with net interest expense of $1.6 million for the year ended December 31, 2002. The decrease in interest expense is primarily due to lower interest rates during 2003 and reduced short-term borrowing balances resulting from strong operating cash flows.

Income taxes

The Company recorded a provision for income taxes of $20.6 million for the year ended December 31, 2003, compared to $21.9 million for the year ended December 31, 2002. Excluding the tax effect of the 2002 restructuring charge, the Company's provision for income taxes was $20.6 million in 2003 compared to $22.9 million for 2002. The Company's effective tax rate for the years ended December 31, 2003 and 2002 was 35%. The Company expects its tax rate for 2004 to be 34%.

Net income

The Company's net income decreased to $38.2 million for the year ended December 31, 2003 from $40.6 million for the year ended December 31, 2002, a decrease of $2.4 million or 5.9%. Excluding the 2002 European restructuring after-tax charge of $1.8 million, net income decreased to $38.2 million for the year ended December 31, 2003 from $42.4 million for the year ended December 31, 2002, a decrease of $4.2 million, or 9.9%.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Net sales

Net sales increased to $489.6 million for the year ended December 31, 2002 from $429.3 million for the year ended December 31, 2001, an increase of $60.3 million, or 14.0%. One factor contributing to the growth in net sales was a 9.5% increase in gross sunglass sales. Gross sunglass sales were $330.2 million for the year ended December 31, 2002 compared to $301.6 million for the year ended December 31, 2001. The growth in gross sunglass sales is composed of a 9.8% increase in average selling price slightly offset by a 0.3% decrease in sunglass unit volume. The increase in average selling price is attributable to the continued shift in product mix to more technical and premium-priced items, the weakening of the U.S. dollar, increasing contribution from the Company's retail stores and the impact of a $5 retail price increase in North America on most sunglasses in July 2001. Several factors contributed to the unit decline including soft consumer spending and reduced demand attributable to the weak retail environment, especially in the latter half of the year. In addition, delayed deliveries of 2002 summer sunglass introductions to retailers resulted in fewer inventory turns during the summer selling season and a reduction of the level of reorders during the holiday season. The delayed deliveries were a result of key raw material shortages caused in part by greater increases in summer demand than originally anticipated. In addition, Sunglass Hut's return as a customer negatively impacted demand from the Company's other retailers in the fourth quarter, compared to the prior year period when Sunglass Hut was not purchasing Oakley products. The increase in gross sunglass sales was driven by strong sunglass sales of the Company's newer sunglasses such as the *Half Jacket, Splice, Wire Tap,* and *Half Wire*, introduced in 2002, the *Switch* and *E-Wire 2.1* , introduced in 2001 , and the *Square Wire 2.0* introduced in 2000, offsetting declines in sales of more mature products. Sales of the Company's polarized styles for the year ended December 31, 2002 also contributed to the increase in gross sales with a 32.2%, or $5.8 million, increase over the year ended December 31, 2001. Gross sales from the Company's newer product categories, comprised of footwear, apparel, watches and prescription eyewear, represented 25.3% of the Company's total gross sales for 2002, compared to 22.4% in 2001. Sales from these newer product categories increased 32.7%, or $32.9 million, to $133.7 million for the year ended December 31, 2002 from $100.8 million for the year ended December 31, 2001. Apparel gross sales increased 49.3% to $56.6 million in 2002, compared with $37.9 million in 2001. Prescription eyewear revenue doubled in each of the three years prior to 2002. In 2002, prescription eyewear gross sales grew 38.5% to $34.3 million in 2002, compared to $24.7 million in 2001. Footwear gross sales grew 4.0% to $31.2 million in 2002 over $30.0 million in 2001. The growth rate for the Company's footwear business was more modest when compared to the other newer categories due to reduced orders and limited distribution for the Company's fall footwear line. Watch gross sales increased 41.5% to $11.6 million in 2002, compared to $8.2 million in 2001. Management believes these increases are a result of its expanded product lines, expanded distribution and retail initiatives, including its greater dealer base, and increasing consumer acceptance of the Company's newer categories.

The Company's total U.S. net sales increased 19.2% for the year ended December 31, 2002 to $254.0 million from $213.2 million in 2001. Excluding the Company's retail store operations, U.S. net sales increased 8.4% to $221.4 million in the year ended December 31, 2002 from $204.3 million in 2001, as a result of a 15.4% increase in sales to the Company's largest U.S. customer, Sunglass Hut and its affiliates, coupled with a 6.5% increase in net sales to the Company's broad specialty store account base and other domestic sales. Sales to Sunglass Hut increased $6.7 million to $50.3 million for the year ended December 31, 2002 from $43.6 million for the year ended December 31, 2001. In April 2001, Luxottica, one of the Company's largest competitors, acquired Sunglass Hut, and implemented changes which adversely affected the Company's net sales to Sunglass Hut in the latter half of 2001. In December 2001, the Company and Luxottica entered into a new three-year commercial agreement for the distribution of Oakley products through Sunglass Hut retail stores which marked the resumption of the business relationship between the two companies.

Net sales from the Company's retail store operations, including Iacon acquired on October 31, 2001, were $32.6 million for the year ended December 31, 2002, up from $8.9 million for the year ended December 31, 2001, an increase of $23.7 million. During the year ended December 31, 2002, the Company added 21 new Iacon stores, bringing the total stores to 64 at December 31, 2002, and eight new Oakley stores, bringing the total to 14. Retail sales represented 6.7% of total net sales for 2002.

During the year ended December 31, 2002, the Company's international net sales increased 9.0%, or $19.4 million, to $235.5 million from $216.1 million during the year ended December 31, 2001. On a constant dollar basis, international sales grew 7.5% for the year ended December 31, 2002 when compared to the year ended December 31, 2001. Although the Company's international sales during the year have been impacted by weak retail environments, especially in Europe and Japan, all major markets other than Latin America experienced growth during the year. During the second quarter of 2002, international net sales were more adversely affected than U.S. net sales by the sunglass delivery issues discussed above due to the longer lead times required for delivery outside the United States. In addition, the Company's 2002 European sunglass sales were impacted by competitive pressures from strong fashion brands. Latin America experienced a large decrease in net sales in the 2002 period due to delays in the transition to direct distribution in Brazil from the previous independent distributor and overall weak economic conditions in the region. Sales from the Company's direct international offices represented 84.9% of total international sales for 2002, compared to 82.0% for 2001.

Gross profit

Gross profit increased to $277.6 million, or 56.7% of net sales, for the year ended December 31, 2002 from $254.9 million, or 59.4% of net sales, for the year ended December 31, 2001, an increase of $22.7 million, or 8.9%. The decrease in gross profit as a percentage of net sales reflects higher overall sales discounts, coupled with a lower concentration of sunglass and prescription eyewear products relative to sales of lower gross margin product categories. Iacon sales of sunglass brands other than Oakley, as well as the associated occupancy costs, have also had a negative impact on the Company's year over year gross margin comparison due to Iacon being included for only two months of the comparable 2001 period. Foreign exchange had a favorable impact on gross margin relative to the comparable period. The Company's footwear margins were lower in 2002 when compared to 2001 due to successful efforts to reduce inventory levels of prior season close-out products at reduced margins, increased tooling costs per unit and provisions for slow-moving inventory.

Operating expenses

In December 2002, the Company announced plans to restructure its European operations with significant changes to the regional sales and distribution organization. As part of this plan, relationships with several outside sales agents have been modified or terminated, and changes are being implemented to rationalize other warehousing and distribution functions within the European markets which resulted in a $2.8 million pre-tax charge to selling and shipping and warehousing expenses. See Note 14 in *Notes to Consolidated Financial Statements* . Operating expenses for the year ended December 31, 2002 increased to $213.4 million from $180.9 million for the year ended December 31, 2001, an increase of $32.5 million, or 18.0%. As a percentage of net sales, operating expenses increased to 43.6% of net sales for the year ended December 31, 2002 compared to 42.1% of net sales for 2001. Excluding the $2.8 million European restructuring charge, operating expenses increased to $210.6 million, or 43.0% of net sales, for the year ended December 31, 2002 from $180.9 million, or 42.1%, for the year ended December 31, 2001, an increase of $29.7 million, or 16.4%. Operating expenses included $12.3 million of expenses for the Company's retail store operations, an increase of $8.9 million from $3.4 million for the year ended December 31, 2001. Research and development expenses increased $4.7 million to $16.0 million, or 3.3% of net sales, for the year ended December 31, 2002, from $11.3 million, or 2.6% of net sales, for the year ended December 31, 2001, primarily as a result of greater new product development efforts in all product categories. Selling expenses increased $18.1 million to $127.0 million, or 25.9% of net sales, for the year ended December 31, 2002 from $108.9 million, or 25.4% of net sales, for the year ended December 31, 2001. Excluding $2.3 million relating to the European restructuring charge, selling expenses were $124.7 million for the year ended December 31, 2002, compared to $108.9 million for the year ended December 31, 2001, an increase of $15.8 million. This increase was a result of (i) increased sales salaries primarily due to the increased retail operations, (ii) increased sports marketing expenses primarily for footwear and apparel and (iii) displays and display depreciation to support the new distribution initiatives, partially offset by reduced commissions due to a realigned commission structure. As a percentage of net sales, selling expenses excluding the restructure charge remained at 25.5% of net sales for the year ended December 31, 2002. Shipping and warehousing expenses as a percentage of net sales decreased to 3.7% of net sales for the year ended December 31, 2002 from 4.0% of net sales for the year ended December 31, 2001. Excluding $0.5 million related to the European restructuring charge, shipping and warehousing expenses as a percentage of sales decreased to 3.6% of net sales for the year ended December 31, 2002 from 4.0% of net sales for the year ended December 31, 2001 as the Company leveraged its shipping expenses over higher sales. This leverage resulted from labor and freight cost efficiencies offsetting increased international third party distribution costs. General and administrative expenses increased $8.7 million to $52.3 million, or 10.7% of net sales, for the year ended December 31, 2002, from $43.6 million, or 10.2% of net sales, for the year ended December 31, 2001. The increase in general and administrative expenses was principally a result of greater personnel-related and administrative costs and information technology costs necessary to support and manage the Company's growth, as well as increased retail store expenses. These increases were partially offset by the reduction of amortization expense for the year ended December 31, 2002 of approximately $1.2 million primarily due to the adoption of SFAS No. 142. See Note 5 in *Notes to Consolidated Financial Statements* .

Operating income

The Company's operating income decreased to $64.2 million, or 13.1% of net sales, for the year ended December 31, 2002 from $74.1 million, or 17.3% of net sales, a decrease of $9.9 million. Excluding the European restructuring charge of $2.8 million, the Company's operating income decreased $7.1 million to $67.0 million for the year ended December 31, 2002 from $74.1 million for the year ended December 31, 2001. As a percentage of net sales, operating income, prior to the restructure charge, decreased to 13.7% for the year ended December 31, 2002 from 17.3% for the year ended December 31, 2001.

Interest expense, net

The Company had net interest expense of $1.6 million for the year ended December 31, 2002, as compared with net interest expense of $3.1 million for the year ended December 31, 2001. The decrease in interest expense is due to lower interest rates during 2002, reduced short-term borrowing balances resulting from the improved balance sheet trends and a nonrecurring credit to interest expense of approximately $350,000 resulting from the favorable settlement of a treasury hedge entered into by the Company in connection with the previously announced long-term debt financing, which the Company elected not to pursue in the quarter ended June 30, 2002.

Income taxes

The Company recorded a provision for income taxes of $21.9 million for the year ended December 31, 2002 compared to $20.6 million for the year ended December 31, 2001. Excluding the tax effect of the restructuring charge, the Company's provision for income taxes was $22.9 million in 2002 compared to $20.6 million for 2001. The Company's effective tax rate for the year ended

December 31, 2002 was 35%, compared to 29% for the comparable period in 2001 which resulted from a one-time tax benefit associated with the Company's foreign operations in 2001.

Net income

The Company's net income decreased to $40.6 million for the year ended December 31, 2002 from $50.4 million for the year ended December 31, 2001, a decrease of $9.8 million or 19.4%. Excluding the European restructuring after-tax charge of $1.8 million, net income decreased to $42.4 million for the year ended December 31, 2002 from $50.4 million for the year ended December 31, 2001, a decrease of $8.0 million, or 15.9%.

Liquidity and Capital Resources

The Company historically has financed its operations almost entirely with cash flow generated from operations and borrowings from its credit facilities. Cash provided by operating activities totaled $76.1 million for the year ended December 31, 2003 compared to $87.6 million for the year ended December 31, 2002. The Company's cash balance was $49.2 million at December 31, 2003 compared to $22.2 million at December 31, 2002. At December 31, 2003, working capital was $154.5 million compared to $129.0 million at December 31, 2002, a 19.8% increase. Working capital may vary from time to time as a result of seasonality, new product category introductions and changes in accounts receivable and inventory levels. Accounts receivable balances, less allowance for doubtful accounts, totaled $78.0 million at December 31, 2003, compared to $68.1 million at December 31, 2002, with accounts receivable days outstanding for the year ended December 31, 2003 of 51, compared to 53 for the year ended December 31, 2002. Inventories increased to $98.7 million at December 31, 2003, compared to $87.0 million at December 31, 2002. This inventory reflects the expanded Company-owned retail operations and increased apparel and footwear inventory to support the new spring releases. Inventory turns were 2.4 at December 31, 2003, compared to 2.6 at December 31, 2002.

Credit Facilities

In January 2001, the Company amended its unsecured line of credit with a bank syndicate which allows for borrowings up to $75 million and matures in August 2004. The amended line of credit bears interest at either LIBOR or IBOR plus 0.75% (1.86% at December 31, 2003) or the bank's prime lending rate minus 0.25% (3.75% at December 31, 2003). At December 31, 2003, the Company did not have any balance outstanding under such facility. The credit agreement contains various restrictive covenants including the maintenance of certain financial ratios. At December 31, 2003, the Company was in compliance with all restrictive covenants and financial ratios. The Company believes that it will be able to extend or replace its existing credit facility prior to its maturity without significant changes in terms. Certain of the Company's foreign subsidiaries have negotiated local lines of credit to provide working capital financing. The aggregate U.S. dollar borrowing limit on the foreign lines of credit is approximately $24.1 million, of which $14.0 million was outstanding at December 31, 2003. The Company also has a real estate term loan, which is collateralized by the Company's corporate headquarters and requires quarterly principal payments of approximately $380,000 plus interest based on LIBOR plus 1.00% (2.17% at December 31, 2003). In January 1999, the Company entered into an interest rate swap agreement that results in fixing the interest rate over the term of the loan at 6.31%. At December 31, 2003, the outstanding balance on the term loan was $13.3 million. The term loan is due in September 2007.

Note Payable

The Company also has a note in the amount of $1.4 million, net of discounts, as of December 31, 2003, payable as a result of an acquisition. Payments under the note are due in annual installments of $500,000 ending in 2006, with such payments contingent upon certain conditions.

Capital Expenditures

Capital expenditures, net of retirements, for the year ended December 31, 2003 were $28.2 million, which included $7.1 million for retail store operations. Included in 2003 capital expenditures, excluding capital expenditures for retail operations, were $5.7 million for production equipment and new product tooling, $5.3 million for information technology infrastructure, including software, computers and related equipment, $7.9 million for in-store displays and $6.3 million for facility building improvements, furniture and fixtures and autos.

Stock Repurchase

In September 2002, the Company's Board of Directors authorized the repurchase of $20 million of the Company's common stock to occur from time to time as market conditions warrant. Under this program, as of December 31, 2003, the Company had purchased 829,600 shares of its common stock at an aggregate cost of approximately $8.6 million, or an average cost of $10.37 per share. Approximately $11.4 million remains available for repurchases under the current authorization with total common shares outstanding of 67,948,482 as of December 31, 2003.

Dividends

On August 12, 2003, the Company's Board of Directors announced the initiation of an annual dividend policy and declared an initial annual cash dividend of $0.14 per share. This dividend, totaling $9.5 million, was paid on October 31, 2003 to shareholders of record as of the close of business on October 15, 2003. Any future dividends are at the discretion, and subject to the approval, of the Company's Board of Directors.

Contractual Obligations and Commitments

The following table gives additional guidance related to the Company's future obligations and commitments as of December 31, 2003:

(in thousands)	2004	2005	2006	2007	2008	Thereafter
Lines of credit	$ 14,039	$ —	$ —	$ —	$ —	$ —
Long-term debt	1,519	1,519	1,519	8,731	—	—
Note payable	500	500	500	—	—	—
Letters of credit	4,591	—	—	—	—	—
Operating leases	14,788	14,020	12,862	11,583	10,490	30,228
Endorsement contracts	6,853	2,844	3	2	—	—
	$ 42,290	$ 18,883	$ 14,884	$ 20,316	$ 10,490	$ 30,228

Additionally, the Company expects 2004 capital expenditures to be approximately $33.0 million, including approximately $8.0 million for expansion of both Oakley and Iacon retail operations. As of December 31, 2003, the Company had commitments of approximately $1.1 million for future capital purchases.

Warranty Provision

The Company provides warranties against manufacturer's defects for all of its products and maintains a reserve for its product warranty liability based on estimates calculated using historical warranty experience. Warranty liability activity for the years ended December 31, was as follows:

(in thousands)	2003	2002	2001
Balance as of January 1,	$ 3,537	$ 3,503	$ 3,992
Warranty claims and expenses	(3,511)	(4,224)	(3,444)
Provisions for warranty expense	2,851	4,224	2,962
Changes due to foreign currency translation	44	34	(7)
Balance as of December 31,	$ 2,921	$ 3,537	$ 3,503

The Company believes that existing capital, anticipated cash flow from operations, and current and anticipated borrowings under its current or future credit facilities will be sufficient to meet operating needs and capital expenditures for the foreseeable future. The Company's short-term funding comes from its current revolving line of credit which contains various restrictive covenants including the maintenance of certain financial ratios. At December 31, 2003, the Company was in compliance with all restrictive covenants and financial ratios.

Seasonality

The following table sets forth certain unaudited quarterly data for the periods shown:

	2003				2002			
	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
	(in thousands)							
Net sales	$ 111,190	$ 143,841	$ 144,963	$ 121,555	$ 109,572	$ 145,144	$ 131,913	$ 102,923
Gross profit	59,415	87,970	82,492	64,826	57,683	91,067	74,284	54,556

Historically, the Company's aggregate sales have been highest in the period from March to September, the period during which sunglass use is typically highest in the northern hemisphere. As a result, operating margins are typically lower in the first and fourth quarters, as fixed operating costs are spread over lower sales volume. In anticipation of seasonal increases in demand, the Company typically builds sunglass inventories in the fourth quarter and first quarter when net sales have historically been lower. In addition, sales of other products, which generate gross profits at lower levels than sunglasses, are generally lowest in the second quarter. This seasonal trend contributes to the Company's gross profit in the second quarter, which historically has been the highest of the year. Although the Company's business generally follows this seasonal trend, new product category introductions, such as apparel, footwear and watches, and the Company's retail and international expansion have partially mitigated the impact of seasonality.

Backlog

Historically, the Company has generally shipped most eyewear orders within one day of receipt, with longer lead times for its other pre-booked product categories. At December 31, 2003, the Company had a backlog of $51.9 million, including backorders (merchandise remaining unshipped beyond its scheduled shipping date) of $5.3 million, compared to a backlog of $42.7 million, including backorders of $5.7 million, at December 31, 2002. Included in this backlog are orders for the Company's footwear and apparel lines, which totaled $43.8 million at December 31, 2003, up 22.0% compared with $35.9 million at December 31, 2002.

Inflation

The Company does not believe inflation has had a material impact on the Company in the past, although there can be no assurance that this will be the case in the future.

New Accounting Pronouncements

Information regarding new accounting pronouncements is contained in Note 1 to the Consolidated Financial Statements for the year ended December 31, 2003, which note is incorporated herein by this reference.

GAAP and Non-GAAP Financial Measures

This document includes a discussion of gross sales and components thereof, each of which may be a non-GAAP financial measure. The Company believes that use of this financial measure allows management and investors to evaluate and compare the Company's operating results in a more meaningful and consistent manner. As required by Item 10 of Regulation S-K, a reconciliation of these measures is as follows:

Reconciliation of Gross Sales to Net Sales:

	Year ended December 31,		
	2003	**2002**	**2001**
	(in thousands)		
Gross sales	$ 560,592	$ 528,781	$ 450,363
Discounts and returns	(39,043)	(39,229)	(21,096)
Net sales	$ 521,549	$ 489,552	$ 429,267

Forward-Looking Statements

This document contains certain statements of a forward-looking nature. Such statements are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. The accuracy of such statements may be impacted by a number of business risks and uncertainties that could cause actual results to differ materially from those projected or anticipated, including: risks related to the Company's ability to manage rapid growth; the ability to identify qualified manufacturing partners; the ability to coordinate product development and production processes with those partners; the ability of those manufacturing partners and the Company's internal production operations to increase production volumes on raw materials and finished goods in a timely fashion in response to increasing demand and enable the Company to achieve timely delivery of finished goods to its retail customers; the ability to provide adequate fixturing to existing and future retail customers to meet anticipated needs and schedules; the dependence on eyewear sales to Sunglass Hut which is owned by a major competitor and, accordingly, could materially alter or terminate its relationship with the Company; the Company's ability to expand distribution channels and its own retail operations in a timely manner; unanticipated changes in general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by retailers; continued weakness of economic conditions could continue to reduce or further reduce demand for products sold by the Company and could adversely affect profitability, especially of the Company's retail operations; further terrorist acts, or the threat thereof, could continue to adversely affect consumer confidence and spending, could interrupt production and distribution of product and raw materials and could, as a result, adversely affect the Company's operations and financial performance; the ability of the Company to integrate acquisitions without adversely affecting operations; the ability to continue to develop and produce innovative new products and introduce them in a timely manner; the acceptance in the marketplace of the Company's new products and changes in consumer preferences; reductions in sales of products, either as the result of economic or other conditions or reduced consumer acceptance of a product, could result in a buildup of inventory; the ability to source raw materials and finished products at favorable prices to the Company; the potential effect of periodic power crises on the Company's operations including temporary blackouts at the Company's facilities; foreign currency exchange rate fluctuations; earthquakes or other natural disasters concentrated in Southern California where substantially all of the companies operations are based; the Company's ability to identify and execute successfully cost control initiatives; and other risks outlined herein and other filings made periodically by the Company. The Company cautions prospective investors not to place undue reliance of such statements and undertakes no obligation to update this forward-looking information.

Item 7a. Quantitative and Qualitative Disclosures about Market Risk

The Company is exposed to a variety of risks, including foreign currency fluctuations and changes in interest rates affecting the cost of its debt.

Foreign currency

The Company has direct operations in Continental Europe, United Kingdom, Japan, Canada, Mexico, South Africa, Australia, New Zealand and Brazil which collect at future dates in the customers' local currencies and purchase finished goods in U.S. dollars. Accordingly, the Company is exposed to transaction gains and losses that could result from changes in foreign currency exchange rates. (See Note 10 in *Notes to Consolidated Financial Statements)* . As part of its overall strategy to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company and its subsidiaries use foreign exchange contracts in the form of forward contracts. All of the Company's derivatives were designated and qualified as cash flow hedges at December 31, 2003.

On the date the Company enters into a derivative contract, management designates the derivative as a hedge of the identified exposure. The Company only enters into derivative instruments that qualify as cash flow hedges as described in SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." For all instruments qualifying as highly effective cash flow hedges, the changes in the fair value of the derivative are recorded in other comprehensive income. The following is a summary of the Company's foreign exchange contracts by currency at December 31, 2003 (in thousands):

	U.S. Dollar Equivalent	Maturity	Fair Value (loss)
Forward Contracts:			
Australian dollar	$ 8,238	Jan. 2004 - Sep. 2004	$ (1,252)
British pound	26,369	Feb. 2004 - Dec. 2004	(2,160)
Canadian dollar	16,382	Jan. 2004 - Dec. 2004	(2,034)
Euro	33,983	Jan. 2004 - Dec. 2004	(4,246)
Japanese yen	14,009	Mar. 2004 - Dec. 2004	(1,227)
South African rand	4,071	Mar. 2004 - Dec. 2004	(897)
	$ 103,052		$ (11,816)

The Company is exposed to credit losses in the event of nonperformance by counterparties to its forward exchange contracts but has no off-balance sheet credit risk of accounting loss. The Company anticipates, however, that the counterparties will be able to fully satisfy their obligations under the contracts. The Company does not obtain collateral or other security to support the forward exchange contracts subject to credit risk but monitors the credit standing of the counterparties. As of December 31, 2003, outstanding contracts were recorded at fair value and the resulting gains and losses were recorded in the consolidated financial statements pursuant to the policy set forth above.

Interest rates

The Company's principal line of credit, with no balance outstanding at December 31, 2003, bears interest at either LIBOR or IBOR plus 0.75% (1.86% at December 31, 2003) or the bank's prime lending rate minus 0.25% (3.75% at December 31, 2003). Based on the weighted average interest rate of 3.83% on the line of credit during the year ended December 31, 2003, if interest rates on the line of credit were to increase by 10%, and to the extent that borrowings were outstanding, for every $1.0 million outstanding on the Company's line of credit, net income would be reduced by approximately $2,000 per year.

The Company's ten-year real estate term loan, with a balance of $13.3 million outstanding at December 31, 2003, bears interest at LIBOR plus 1.0% (2.17% at December 31, 2003) and is due in September 2007. In January 1999, the Company entered into an interest rate swap agreement that eliminates the Company's risk of fluctuations in the variable rate of its long-term loan by fixing the rate at 6.31%. As of December 31, 2003, the fair value of the Company's interest rate swap agreement was a loss of approximately $1.0 million.

Item 8. Financial Statements and Supplementary Data

See*Index to Consolidated Financial Statements* for a listing of the consolidated financial statements submitted as part of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part III

Item 10. Directors and Executive Officers of the Registrant

The information required by this item will be contained in the Company's Proxy Statement for its Annual Shareholders Meeting to be held on June 4, 2004, to be filed with the Securities and Exchange Commission within 120 days after December 31, 2003, and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item will be contained in the Company's Proxy Statement for its Annual Shareholders Meeting to be held on June 4, 2004, to be filed with the Securities and Exchange Commission within 120 days after December 31, 2003, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information required by this item will be contained in the Company's Proxy Statement for its Annual Shareholders Meeting to be held on June 4, 2004, to be filed with the Securities and Exchange Commission within 120 days after December 31, 2003, and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions

The information required by this item will be contained in the Company's Proxy Statement for its Annual Shareholders Meeting to be held on June 4, 2004, to be filed with the Securities and Exchange Commission within 120 days after December 31, 2003, and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item will be contained in the Company's Proxy Statement for its Annual Shareholders Meeting to be held on June 4, 2004, to be filed with the Securities and Exchange Commission within 120 days after December 31, 2003, and is incorporated herein by reference.

Part IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a)
(1) See page 41 for a listing of financial statements submitted as part of this report.

(a)
(2) Schedule II—Valuation and Qualifying Accounts

All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

(a)
(3) The following exhibits are included in this report.

3.1	(1)	Articles of Incorporation of the Company
3.2	(8)	Amended and Restated Bylaws of the Company
3.3	(3)	Amendment No. 1 to the Articles of Incorporation as filed with the Secretary of State of the State of Washington on September 26, 1996
3.4	(8)	Amendment No. 1 to Section 1 and Sections 3a through 3f of Article IV of the Amended and Restated Bylaws of Oakley, Inc.
10.1	(2)	Agreement, dated July 17, 1995, between Oakley, Inc. and Michael Jordan
10.2	(4)	Reciprocal Exclusive Dealing Agreement dated March 11, 1997 among Oakley, Inc., Gentex Optics, Inc. and Essilor International Compagnie Generale D'Optique, S.A. (portions of this document have been omitted pursuant to a request for confidential treatment)
10.3	(4)	Promissory Note, dated March 20, 1997, between Oakley, Inc. and Bank of America National Trust and Savings Association
10.4	(5)	Promissory Note, dated August 7, 1997, between Oakley, Inc. and Bank of America National Trust and Savings Association
10.5	(5)	Amendment No. 1 to Promissory Note, dated August 14, 1997, between Oakley, Inc. and Bank of America National Trust and Savings Association
10.6	(5)	Amendment No. 2 to Promissory Note, dated August 14, 1997, between Oakley, Inc. and Bank of America National Trust and Savings Association
10.7	(5)	Deed of Trust with Assignment of Rents, Security Agreement and Fixture Filing, dated August 7, 1997, between Oakley, Inc. and Bank of America National Trust and Savings Association
10.8	(6)	Amended and Restated Consultant Agreement, dated May 12, 1998, between Jim Jannard and Oakley, Inc.
10.9	(7)	Second Amended and Restated Credit Agreement, dated August 25, 1998, among Oakley, Inc. and Bank of America National Trust and Savings Association, as agent, and the Lenders named therein
10.10	(7)	Modification Agreement (Short Form), dated August 10, 1998, between Oakley, Inc. and Bank of America National Trust and Savings Association
10.11	(7)	Modification Agreement (Long Form), dated August 10, 1998, between Oakley, Inc. and Bank of America National Trust and Savings Association
10.12	(9)	Amended and Restated Employment Agreement, dated May 1, 1999, between Link Newcomb and Oakley, Inc.

10.13	(9)	Oakley, Inc. Amended and Restated 1995 Stock Incentive Plan
10.14	(9)	Oakley, Inc. Amended and Restated Executive Officers Performance Bonus Plan
10.15	(10)	Amendment No. 1 to Amended and Restated Employment Agreement, dated December 31, 1999, between Link Newcomb and Oakley, Inc.
10.16	(10)	Second Amended and Restated Employment Agreement, dated January 1, 2000, between Thomas George and Oakley, Inc.
10.17	(11)	First Amendment to Second Amended and Restated Credit Agreement, dated as of March 6, 2000, among Oakley, Inc. and Bank of America National Trust and Savings Association, as agent, and the Lenders named therein
10.18	(12)	Employment Agreement, dated October 1, 2000, between Tomas Rios and Oakley, Inc.
10.19	(13)	Second Amendment to Second Amended and Restated Credit Agreement, dated October 16, 2000, among Oakley, Inc. and Bank of America National Trust and Savings Association, as agent, and the Lenders named therein
10.20	(13)	Third Amendment to Second Amended and Restated Credit Agreement, dated January 18, 2001, among Oakley, Inc. and Bank of America National Trust and Savings Association, as agent, and the Lenders named therein
10.21	(13)	Lease Agreement, dated November 10, 2000, between Haven Gateway LLC and Oakley, Inc.
10.22	(13)	Trademark License Agreement and Assignment of Rights, dated March 31, 2000, between Y, LLC and Oakley, Inc.
10.23	(14)	Amendment to Trademark License Agreement, dated June 1, 2002, between Y, LLC and Oakley, Inc.
10.24	(15)	Indemnification Agreement, dated February 7, 2003, between Oakley, Inc. and Jim Jannard.
10.25	(15)	Indemnification Agreement, dated February 7, 2003, between Oakley, Inc. and Link Newcomb.
10.26	(15)	Indemnification Agreement, dated February 7, 2003, between Oakley, Inc. and Colin Baden.
10.27	(15)	Indemnification Agreement, dated February 14, 2003, between Oakley, Inc. and Tommy Rios.
10.28	(15)	Indemnification Agreement, dated February 7, 2003, between Oakley, Inc. and Tom George.
10.29	(15)	Indemnification Agreement, dated February 7, 2003, between Oakley, Inc. and Donna Gordon.
10.30	(15)	Indemnification Agreement, dated February 7, 2003, between Oakley, Inc. and Scott Bowers.
10.32	(15)	Indemnification Agreement, dated February 7, 2003, between Oakley, Inc. and Jon Krause.
10.33	(15)	Indemnification Agreement, dated February 7, 2003, between Oakley, Inc. and Kent Lane.
10.35	(15)	Indemnification Agreement, dated February 14, 2003, between Oakley, Inc. and Carlos Reyes.

10.36	(16)	Indemnification Agreement, dated March 26, 2003, between Oakley, Inc. and Irene Miller.
10.37	(16)	Indemnification Agreement, dated March 26, 2003, between Oakley, Inc. and Abbott Brown.
10.38	(16)	Indemnification Agreement, dated March 26, 2003, between Oakley, Inc. and Lee Clow.
10.39	(17)	Aircraft Lease Agreement, dated December 18, 2003, between Oakley, Inc. and N2T, Inc.
10.40	(17)	Indemnification Agreement, dated February 12, 2004, between Oakley, Inc. and Thomas Davin.
21.1	(17)	List of Material Subsidiaries
23.1	(17)	Consent of Deloitte & Touche LLP, independent auditors
31.1	(17)	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	(17)	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	(17)	Certification of CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1)
Previously filed with the Registration Statement on Form S-1 of Oakley, Inc. (Registration No. 33-93080)

(2)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended September 30, 1995.

(3)
Previously filed with the Form 10-K of Oakley, Inc. for the year ended December 31, 1996.

(4)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended March 31, 1997.

(5)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended September 30, 1997.

(6)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended June 30, 1998.

(7)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended September 30, 1998.

(8)
Previously filed with the Form 10-K of Oakley, Inc. for the year ended December 31, 1998.

(9)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended June 30, 1999.

(10)
Previously filed with the Form 10-K of Oakley, Inc. for the year ended December 31, 1999.

(11)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended March 30, 2000.

(12)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended September 30, 2000.

(13)
Previously filed with the Form 10-K of Oakley, Inc. for the year ended December 31, 2000.

(14)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended June 30, 2002.

(15)
Previously filed with the Form 10-K of Oakley, Inc. for the year ended December 31, 2002.

(16)
Previously filed with the Form 10-Q of Oakley, Inc. for the quarter ended March 31, 2003.

(17)
Filed herewith

(b)
Reports on Form 8-K

The Company did not file any reports on Form 8-K during the three months ended December 31, 2003.

The Company furnished a Current Report on Form 8-K, dated October 22, 2003, in connection with the press release issued by the Company on October 22, 2003 announcing its financial results for the fiscal quarter ended September 30, 2003.

Index To Consolidated Financial Statements

Independent Auditors' Report

To the Board of Directors and Shareholders of Oakley, Inc.:

We have audited the accompanying consolidated balance sheets of Oakley, Inc. and subsidiaries (the "Company") as of December 31, 2003 and 2002, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2003. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Oakley, Inc. and subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for goodwill and other intangible assets during 2002 in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

/s/ DELOITTE & TOUCHE LLP
Costa Mesa, California
March 4, 2004

OAKLEY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

	December 31, 2003	December 31, 2002
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 49,211	$ 22,248
Accounts receivable, less allowances of $9,672 (2003) and $8,431 (2002)	77,989	68,116
Inventories, net (Note 3)	98,691	87,007
Other receivables	3,368	5,008
Deferred and prepaid income taxes	9,965	10,686
Prepaid expenses and other assets	8,062	6,271
Total current assets	247,286	199,336
Property and equipment, net	153,583	152,454
Deposits	2,139	2,684
Deferred income taxes	781	470
Goodwill	24,609	21,470
Other assets	6,486	7,536
TOTAL ASSETS	$ 434,884	$ 383,950
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Line of credit (Note 8)	$ 14,039	$ 14,162
Accounts payable	26,837	25,912
Accrued expenses and other current liabilities (Note 6)	36,984	24,337
Accrued warranty (Note 1)	2,921	3,537
Income taxes payable	9,954	361
Current portion of long-term debt (Note 8)	2,019	2,019
Total current liabilities	92,754	70,328
Deferred income taxes	2,884	5,215
Long-term debt, net of current portion	12,642	14,576
COMMITMENTS AND CONTINGENCIES (Note 9)		
SHAREHOLDERS' EQUITY:		
Preferred stock, par value $.01 per share; 20,000,000 shares authorized; no shares issued	—	—
Common stock, par value $.01 per share; 200,000,000 shares authorized; 67,948,000 (2003) and 68,332,000 (2002) issued and outstanding	679	683
Additional paid-in capital	31,126	35,097
Retained earnings	296,970	268,285
Accumulated other comprehensive loss	(2,171)	(10,234)
Total shareholders' equity	326,604	293,831
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 434,884	$ 383,950

See accompanying *Notes to Consolidated Financial Statements*

OAKLEY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except share and per share data)

	Year ended December 31, 2003	2002	2001
Net sales	$ 521,549	$ 489,552	$ 429,267
Cost of goods sold	226,846	211,962	174,332
Gross profit	294,703	277,590	254,935
Operating expenses:			
Research and development	14,308	16,016	11,318
Selling	142,365	126,995	108,948
Shipping and warehousing	19,077	18,083	16,997
General and administrative	58,918	52,335	43,606
Total operating expenses	234,668	213,429	180,869
Operating income	60,035	64,161	74,066
Interest expense, net	1,272	1,643	3,108
Income before provision for income taxes	58,763	62,518	70,958
Provision for income taxes	20,567	21,881	20,587
Net income	$ 38,196	$ 40,637	$ 50,371
Basic net income per common share	$ 0.56	$ 0.59	$ 0.73
Basic weighted average common shares	68,006,000	68,732,000	68,856,000
Diluted net income per common share	$ 0.56	$ 0.59	$ 0.72
Diluted weighted average common shares	68,282,000	69,333,000	69,751,000

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Year ended December 31, 2003	2002	2001
Net income	$ 38,196	$ 40,637	$ 50,371
Other comprehensive income (loss):			
Net unrealized (loss) gain on derivative instruments, net of tax	(4,088)	(4,181)	1,795
Foreign currency translation adjustment, net of tax	12,151	2,378	(3,952)
Other comprehensive income (loss), net of tax	8,063	(1,803)	(2,157)
Comprehensive income	$ 46,259	$ 38,834	$ 48,214

See accompanying *Notes to Consolidated Financial Statements*

OAKLEY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(in thousands, except share data)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance as of January 1, 2001	68,612,000	$ 686	$ 36,484	$ 177,277	$ (6,274)	$ 208,173
Repurchase of common shares (Note 11)	(350,000)	(3)	(4,474)	—	—	(4,477)
Exercise of stock options (Note 11)	559,000	5	5,481	—	—	5,486
Compensatory stock options	—	—	98	—	—	98
Tax benefit related to exercise of stock options	—	—	3,216	—	—	3,216
Net income	—	—	—	50,371	—	50,371
Other comprehensive loss	—	—	—	—	(2,157)	(2,157)
Balance as of December 31, 2001	68,821,000	688	40,805	227,648	(8,431)	260,710
Repurchase of common shares (Note 11)	(666,000)	(7)	(7,986)	—	—	(7,993)
Exercise of stock options (Note 11)	177,000	2	1,827	—	—	1,829
Compensatory stock options	—	—	3	—	—	3
Tax benefit related to exercise of stock options	—	—	448	—	—	448
Net income	—	—	—	40,637	—	40,637
Other comprehensive loss	—	—	—	—	(1,803)	(1,803)
Balance as of December 31, 2002	68,332,000	683	35,097	268,285	(10,234)	293,831
Repurchase of common shares (Note 11)	(436,000)	(4)	(4,487)	—	—	(4,491)
Exercise of stock options (Note 11)	52,000	—	470	—	—	470
Compensatory stock options	—	—	11	—	—	11
Tax benefit related to exercise of stock options	—	—	35	—	—	35
Dividends paid	—	—	—	(9,511)		(9,511)
Net income	—	—	—	38,196	—	38,196
Other comprehensive income	—	—	—	—	8,063	8,063
Balance as of December 31, 2003	67,948,000	$ 679	$ 31,126	$ 296,970	$ (2,171)	$ 326,604

See accompanying *Notes to Consolidated Financial Statements*

OAKLEY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year ended December 31, 2003	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 38,196	$ 40,637	$ 50,371
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	30,790	28,578	23,545
Provision for bad debt expense	1,738	1,877	894
Compensatory stock options and capital contributions	11	3	98
Loss on disposition of equipment	1,413	1,353	130
Deferred income taxes, net	920	(85)	15,728
Changes in assets and liabilities, net of effects of business acquisitions:			
Accounts receivable	(5,403)	5,672	(13,663)
Inventories	(5,847)	(5,925)	(14,398)
Other receivables	1,936	(2,192)	(1,376)
Income taxes receivable	—	6,449	(6,449)
Prepaid expenses and other assets	(1,558)	3,243	(6,369)
Deposits	670	(1,218)	(125)
Accounts payable	(42)	6,034	(5,413)
Accrued expenses and other current liabilities	4,446	2,838	2,691
Accrued warranty	(616)	34	(489)
Income taxes payable	9,458	319	(14,912)
Net cash provided by operating activities	76,112	87,617	30,263
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisitions of property and equipment	(29,772)	(32,992)	(44,702)
Proceeds from sale of property and equipment	192	162	164
Acquisitions of businesses	(430)	—	(8,699)
Other assets	(665)	(288)	(1,432)
Net cash used in investing activities	(30,675)	(33,118)	(54,669)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from bank borrowings	19,037	77,852	156,047
Repayments of bank borrowings	(23,919)	(107,714)	(134,719)
Dividends	(9,511)	—	—
Net proceeds from issuance of common shares	505	2,277	8,702
Repurchase of common shares	(4,491)	(7,993)	(4,477)
Net cash used in financing activities	(18,379)	(35,578)	25,553
Effect of exchange rate changes on cash	(95)	(2,285)	(390)
Net increase in cash and cash equivalents	26,963	16,636	757
Cash and cash equivalents, beginning of period	22,248	5,612	4,855
Cash and cash equivalents, end of period	$ 49,211	$ 22,248	$ 5,612
Supplemental cash flow information:			
Cash paid during the year for:			
Interest	$ 1,526	$ 2,700	$ 4,882
Income taxes (net of refunds received)	$ 8,573	$ 14,582	$ 22,130
Non-cash investing and financing activities:			
During 2002, the Company acquired certain assets through the settlement of accounts receivable (Note 2)	—	$ (2,687)	—

See accompanying *Notes to Consolidated Financial Statements*

Note 1—Significant Accounting Policies and Description of Business

Description of Business

The Company is an innovation-driven designer, manufacturer and distributor of consumer products that include high-performance eyewear, footwear, watches, apparel and accessories. The Company believes its principal strength is its ability to develop products that demonstrate superior performance and aesthetics through proprietary technology and styling. Its designs and innovations are protected by 545 legal patents and 976 trademarks worldwide. The Company operates in two segments: wholesale and U.S. retail with over 100 retail stores at December 31, 2003.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America.

Principles of Consolidation

The consolidated financial statements include the accounts of Oakley, Inc. and its subsidiaries (collectively, the "Company"). Intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the Company's consolidated financial statements in conformity with generally accepted accounting principles necessarily requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities as of the balance sheet dates and the reported amounts of revenue and expense during the reporting periods. Actual results could significantly differ from such estimates.

Cash and Cash Equivalents

For purposes of the consolidated financial statements, investments purchased with an original maturity of three months or less are considered cash equivalents.

Inventories

Inventories are stated at the lower of cost to purchase and/or manufacture the inventory or the current estimated market value of the inventory. The Company regularly reviews its inventory quantities on hand and records a provision for excess and obsolete inventory based primarily on the Company's estimated forecast of product demand and production requirements.

Long-Lived Assets

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are provided for using the straight-line method over the estimated useful lives (generally two to seven years for property and equipment and 39 years for buildings) of the respective assets or, as to leasehold improvements, the term of the related lease if less than the estimated useful service life.

Effective January 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 144, "*Accounting for the Impairment or Disposal of Long-Lived Assets* " (SFAS No. 144), which did not have a material impact on the Company's consolidated financial position or results of operations. In accordance with SFAS No. 144, the Company estimates the future undiscounted cash flows derived from an asset to assess whether or not a potential impairment exists when events or circumstances indicate the carrying value of a long-lived asset may differ. An impairment loss is recognized when the undiscounted future cash flows are less than its carrying amount.

Goodwill and Intangible Assets

The Company adopted Statement of Financial Accounting Standards No. 142, "*Goodwill and Intangible Assets*," (SFAS No. 142), which revises the accounting for purchased goodwill and intangible assets effective January 1, 2002. Under SFAS No. 142, goodwill and intangible assets with indefinite lives are no longer amortized but are tested for impairment annually and also in the event of an impairment indicator. The Company completed the required transitional impairment test and the annual tests through 2003 and determined that no impairment loss was necessary. Any subsequent impairment losses will be reflected in operating income. With the adoption of SFAS No. 142, the Company discontinued amortization of goodwill with indefinite lives in 2002. (See Note 5)

Revenue Recognition

The Company recognizes wholesale revenue when merchandise is shipped to a customer and the risks and rewards of ownership have passed based on the terms of sale. Revenue from the Company's retail store operations is recognized upon purchase by customers at the point of sale. Generally, the Company extends credit to its wholesale customers and does not require collateral. The Company performs ongoing credit evaluations of those customers and historic credit losses have been within management's expectations. Sales agreements with dealers and distributors normally provide general payment terms of 30 to 120 days, depending on the product category. The Company's standard sales agreements with its customers do not provide for any rights of return by the customer other than returns for product warranty related issues. In addition to these product warranty related returns, the Company occasionally accepts other returns at its discretion. The Company records a provision for sales returns and claims based upon historical experience. Actual returns and claims in any future period may differ from the Company's estimates. In addition, although the Company, at its sole discretion, may repurchase its own products to protect the Company image, this practice is infrequent and, historically, the value of these repurchases has not been significant.

Financial Instruments

The carrying amounts of financial instruments, consisting of cash and cash equivalents, trade accounts receivable and accounts payable, approximate fair value due to the short period of time between origination of the instruments and their expected realization. Management also believes the carrying amount of balances outstanding under the credit agreements approximates fair value as the underlying interest rates reflect market rates.

Accounts Receivable

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customer's current creditworthiness, as determined by the Company's review of their current credit information. The Company continuously monitors its customer collections and payments and maintains a provision for estimated credit losses based upon the Company's historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within the expectations and the provisions established by the Company, there can be no assurances that the Company will continue to experience the same credit loss rates that have been experienced in the past.

Insurance Coverage

The Company is partially self-insured for its worker's compensation insurance coverage. Under this insurance program, the Company is liable for a deductible of $250,000 for each individual claim and an aggregate annual liability of $1,368,000. The Company records a liability for the estimated cost of claims both reported and incurred but not reported based upon its historical experience. The estimated costs include the estimated future cost of all open claims. The Company will continue to adjust the estimates as the actual experience dictates. A significant change in the number or dollar amount of claims could cause the Company to revise its estimate of potential losses and affect its reported results.

Warranties

The Company provides a one-year limited warranty against manufacturer's defects in its eyewear. All authentic Oakley watches are warranted for one year against manufacturer's defects when purchased from an authorized Oakley watch dealer. Footwear is warranted for 90 days against manufacturer's defects, and apparel is warranted for 30 days against manufacturer's defects. The Company's standard warranties require the Company to repair or replace defective product returned to the Company during such warranty period. The Company maintains a reserve for its product warranty liability based on estimates calculated using historical warranty experience. While warranty costs have historically been within the Company's expectations, there can be no assurance that the Company will continue to experience the same warranty return rates or repair costs as in the prior years. A significant increase in product return rates, or a significant increase in the costs to repair product, could have a material adverse impact on the Company's operating results.

Warranty liability activity for the years ended December 31, was as follows:

(in thousands)	**2003**	**2002**	**2001**
Balance as of January 1,	$ 3,537	$ 3,503	$ 3,992
Warranty claims and expenses	(3,511)	(4,224)	(3,444)
Provisions for warranty expense	2,851	4,224	2,962
Changes due to foreign currency translation	44	34	(7)
Balance as of December 31,	$ 2,921	$ 3,537	$ 3,503

Income Taxes

The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards No. 109, "*Accounting for Income Taxes* " (SFAS No. 109). 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. The Company considers future taxable income and ongoing, prudent and feasible tax planning strategies in assessing the value of its deferred tax assets. If the Company determines that it is more likely than not that these assets will not be realized, the Company will 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 the Company's judgment. If the Company subsequently determined that the deferred tax assets, which had been written down, would 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.

Foreign Currency Translation

The Company has direct operations in Continental Europe, United Kingdom, Japan, Canada, Mexico, South Africa, Australia, New Zealand and Brazil which collect at future dates in the customers' local currencies and purchase finished goods in U.S. dollars. Accordingly, the Company is exposed to transaction gains and losses that could result from changes in foreign currency. Assets and liabilities of the Company 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 (loss). Gains and losses on short-term intercompany foreign currency transactions are recognized as incurred. As part of the Company's overall strategy to manage its level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company and its subsidiaries have entered into various foreign exchange contracts in the form of forward contracts.

Comprehensive Income

Comprehensive income represents the results of operations adjusted to reflect all items recognized under accounting standards as components of comprehensive earnings.

The components of comprehensive income for the Company include net income, unrealized gains or losses on foreign currency cash flow hedges, unrealized gains or losses on an interest rate swap, and foreign currency translation adjustments. The components of accumulated other comprehensive loss, net of tax, are as follows:

(in thosands)	Years ended December 31, 2003	2002
Unrealized loss on foreign currency cash flow hedges, net of tax	$ (7,609)	$ (3,205)
Unrealized loss on interest rate swap, net of tax	(606)	(922)
Equity adjustment from foreign currency translation, net of tax	6,044	(6,107)
	$ (2,171)	$ (10,234)

Stock-Based Compensation

The Company accounts for stock-based awards to employees using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, " *Accounting for Stock Issued to Employees* ," under which no compensation expense is recognized for stock option awards granted with exercise prices at fair market value. Stock based awards to non-employees are accounted for using the fair value method in accordance with Statement of Financial Accounting Standards No. 123, " *Accounting for Stock Based Compensation* " (SFAS No. 123).

SFAS No. 123 requires the disclosure of pro forma net income and earnings per share had the Company adopted the fair value method in accounting for stock-based awards as of the beginning of fiscal 1995.

Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option-pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. The Company's calculations were made using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2003	2002	2001
Stock volatility	47.1%-58.2%	44.1%-81.1%	58.1%-83.7%
Risk-free interest rate	2.1%	2.8%	3.8%
Expected dividend yield	1.4%	0%	0%
Expected life of option	1-4 years	1-4 years	1-4 years

If the computed fair value of the 2003, 2002 and 2001 awards had been amortized to expense over the vesting period of the awards, net income would have been as follows:

(in thousands)	2003	2002	2001
Net income:			
As reported	$ 38,196	$ 40,637	$ 50,371
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of tax effects	(3,071)	(3,639)	(2,964)
Pro forma	$ 35,125	$ 36,998	$ 47,407
Basic net income per share:			
As reported	$ 0.56	$ 0.59	$ 0.73
Pro forma	$ 0.52	$ 0.54	$ 0.69
Diluted net income per share:			
As reported	$ 0.56	$ 0.59	$ 0.72
Pro forma	$ 0.51	$ 0.54	$ 0.68

Earnings Per Share

Basic earnings per share is computed using the weighted average number of common shares outstanding during the reporting period. Earnings per share assuming dilution is computed using the weighted average number of common shares outstanding and the dilutive effect of potential common shares outstanding. For the years ended December 31, 2003, 2002 and 2001, the diluted weighted average common shares outstanding includes diluted shares for stock options totaling 276,000, 601,000 and 895,000, respectively.

Advertising Costs

The Company advertises primarily through print media, catalogs and in-house mailers. The Company's policy is to expense advertising costs associated with print media on the date the print media is released to the public. Costs associated with catalogs and direct mail materials are expensed as they are shipped to the Company's customers. Advertising costs also include posters and other point-of-purchase materials which are expensed as incurred. Advertising expenses for 2003, 2002 and 2001 were $17,612,000, $18,432,000 and $17,922,000, respectively.

New Accounting Pronouncements

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "*Accounting for Costs Associated with Exit or Disposal Activities* " (SFAS No. 146), which addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes Emerging Issues Task Force (EITF) Issue 94-3, " *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring).* " SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost as defined in EITF Issue 94-3 is recognized on the date of an entity's commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The adoption of SFAS No. 146 on January 1, 2003 did not have a material impact on the Company's financial position or results of operation.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN No. 45), "*Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others."* FIN No. 45 elaborates on the disclosures to be made by the guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002; the provisions of the disclosure requirements are effective for financial statements of interim or annual reports ending after December 15, 2002. The Company's adoption of FIN No. 45 has not had a material impact on the Company's financial position or results of operations.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "*Accounting for Stock-Based Compensation—Transition and Disclosure* " (SFAS No. 148). SFAS No. 148 amends Statement of Financial Accounting Standards No. 123, " *Accounting for Stock-Based Compensation"* (SFAS No. 123), to provide new guidance concerning the transition when a company voluntarily elects to change from the intrinsic-value method to SFAS No. 123's fair value method of accounting for stock-based employee compensation (the "fair value method"). In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has elected not to voluntarily change to the fair value method of accounting for stock-based employee compensation and has followed the prescribed disclosure format and additional disclosures required by SFAS No. 148 under "Stock-Based Compensation."

In January 2003, the FASB issued Interpretation No. 46, "*Consolidation of Variable Interest Entities"* (FIN No. 46) and in December 2003, issued Interpretation No. 46 (revised December 2003) " *Consolidation of Variable Interest Entities—An Interpretation of APB No. 51* ." In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN No. 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN No. 46 (R) clarifies the application of Accounting Research Bulletin No. 51, " *Consolidated Financial Statements* " (APB No. 51), to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without subordinated financial support from other parties. The consolidation requirements of FIN No. 46 applies immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. FIN No. 46 (R) applies immediately to variable interest entities created after December 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. It applies no later than the first reporting period ending after December 15, 2004, to variable interest entities in which an enterprise holds a variable interest (other than special purpose) that it acquired before January 1, 2004. FIN No. 46 (R) applies to public enterprises as of the beginning of the applicable interim or annual period. The Company believes that the adoption of FIN No. 46 and FIN No. 46 (R) will not have a material impact on its financial position or results of operations because the Company has no variable interest entities.

Reclassifications

Certain reclassifications have been made to prior period financial statements to conform to the presentation for the financial statements for the period ended December 31, 2003.

Certain Significant Risks and Uncertainties

General Business

The Company's historical success is attributable, in part, to its introduction of products which are perceived to represent an improvement in performance over products available in the market. The Company's future success will depend, in part, upon its continued ability to develop and introduce such innovative products, and there can be no assurance of the Company's ability to do so. The consumer products industry, including the eyewear, apparel, footwear and watch categories, is fragmented and highly competitive. In order to retain its market share, the Company must continue to be competitive in the areas of quality, technology, method of distribution, style, brand image, intellectual property protection and customer service. These industries are subject to changing consumer preferences and shifts in consumer preferences may adversely affect companies that misjudge such preferences.

In addition, the Company has experienced significant growth under several measurements which has placed, and could continue to place, a significant strain on its employees and operations. If management is unable to anticipate or manage growth effectively, the Company's operating results could be materially adversely affected.

Inventories

Demand for the Company's products can fluctuate significantly. Factors which could affect demand for the Company's products include unanticipated changes in general market conditions or other factors, which may result in cancellations of advance orders or a reduction in the rate of reorders placed by retailers; continued weakening of economic conditions, which could reduce demand for products sold by the Company and which could adversely affect profitability; and future terrorist acts or war, or the threat thereof, which could adversely affect consumer confidence and spending, interrupt production and distribution of product and raw materials and, as a result, adversely affect the Company's operations and financial performance. Additionally, management's estimates of future product demand may be inaccurate, which could result in an understated or overstated provision required for excess and obsolete inventory.

Vulnerability Due to Supplier Concentrations

The Company relies on a single source for the supply of several components, including the uncoated lens blanks from which substantially all of its sunglass lenses are cut. In the event of the loss of its source for lens blanks, the Company has identified an alternate source which may be available. The effect of the loss of any of these sources (including any possible disruption in business) will depend primarily upon the length of time necessary to find a suitable alternative source and could have a material adverse effect on the Company's business. There can be no assurance that, if necessary, an additional source of supply for lens blanks or other critical materials can be located or developed in a timely manner.

Vulnerability Due to Customer Concentrations

Net sales to the retail group of Luxottica S.p.A ("Luxottica"), which include Sunglass Hut locations worldwide, were approximately 9.0%, 12.2% and 12.0% of the Company's net sales for the years ended December 31, 2003, 2002 and 2001, respectively. Luxottica is also one of the Company's largest competitors in the sunglass and optical frame markets. Luxottica acquired Sunglass Hut in April 2001 and implemented changes which adversely affected the Company's net sales to Sunglass Hut in 2001. In December 2001, the Company and Luxottica entered into a new three-year commercial agreement for the distribution of Oakley products through Sunglass Hut retail stores which marked the resumption of the business relationship between the two companies after a short disruption that began in August 2001. The arrangements between the companies do not obligate Luxottica to order product from the Company, and there can be no assurances as to the future of the relationship between the Company and Luxottica. In September 2003, Luxottica completed the acquisition of all the shares of Australian eyewear retailer OPSM Group Ltd ("OPSM"). OPSM operates in the South Pacific and Southeast Asia regions with approximately 600 retail locations, a portion of which currently offer some of the Company's products. For 2003, the Company's net sales to OPSM prior to the acquisition were approximately AUD $1.1 million (or approximately $0.7 million in U.S. dollars based on the average exchange rate for 2003). For 2002, the Company's net sales to OPSM were approximately AUD $2.8 million (or approximately $1.5 million in U.S. dollars based on the average exchange rate for 2002). These sales exclude a limited amount of sales generated through the Company's international distributors. In November 2003, Luxottica completed the acquisition of New Zealand eyewear retailer Sunglass Store New Zealand ("SSNZ"), the Company's largest customer in New Zealand. SSNZ operates in New Zealand with 16 retail locations which offer some of the Company's products. In January 2004, Luxottica entered into a definitive merger agreement with Cole National Corporation ("Cole"), one of the largest optical retailers and largest chain providers of managed vision care services worldwide. This merger is expected to close in the second half of 2004 pending the approval of Cole's stockholders and its compliance with applicable antitrust requirements. The Company currently sells to a small portion of Cole's retail locations and sales to this customer have been immaterial. There can be no assurance that the recent acquisitions or future acquisitions by Luxottica will not have a material adverse impact on the Company's financial position or results of operations.

Note 2—Acquisitions

During 2002, the Company transitioned its operations in Brazil to direct distribution from the previous independent distributor and acquired certain intangible assets on May 29, 2002. On October 31, 2001, the Company acquired one of its largest U.S. customers, Iacon, Inc., a sunglass specialty retailer. These acquisitions have been recorded using the purchase method of accounting and the results of operations from the date of acquisitions have been included in the Company's consolidated financial statements. The purchase price for these acquisitions were allocated on the respective date of acquisitions as follows:

(in thousands)	Brazil 2002	Iacon 2001
Inventories, net	$ 187	$ 2,747
Other current assets	—	448
Property and equipment, net	500	2,276
Identified intangible assets	2,000	574
Goodwill	—	7,760
Assumed liabilities	—	(4,986)
	$ 2,687	$ 8,819

The excess of the purchase prices over the fair values of the net assets acquired have been allocated to intangible assets and goodwill. Had the acquisitions occurred at the beginning of the fiscal year in which they were completed, or the beginning of the immediately preceding year, combined pro forma net sales, net income and net income per common share would not have been materially different from that currently being reported.

Note 3—Inventories

Inventories at December 31, consist of the following:

(in thousands)	2003	2002
Raw materials	$ 21,310	$ 22,188
Finished goods	77,381	64,819
	$ 98,691	$ 87,007

Note 4—Property and Equipment

Property and equipment at December 31, consist of the following:

(in thousands)	2003	2002
Land	$ 8,953	$ 8,979
Buildings and leasehold improvements	92,537	84,471
Equipment and furniture	184,688	163,556
Tooling	24,024	23,883
	310,202	280,889
Less accumulated depreciation and amortization	(156,619)	(128,435)
	$ 153,583	$ 152,454

Note 5—Goodwill and Intangible Assets

On January 1, 2002, the Company adopted SFAS No. 142 which eliminated the amortization of purchased goodwill and other intangibles with indefinite useful lives. Upon adoption of SFAS No. 142, the Company performed an impairment test of the carrying value of its goodwill and intangible assets, and determined that no impairment existed. Under SFAS No. 142, goodwill and non-amortizing intangible assets will be tested for impairment at least annually and more frequently if an event occurs which indicates that goodwill or intangible assets may be impaired.

Included in other assets in the accompanying consolidated balance sheets are the following amortizing intangible assets.

	As of December 31, 2003		As of December 31, 2002	
(in thousands)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Covenants not to compete	$ 4,284	$ 2,452	$ 4,267	$ 1,955
Distribution rights	3,567	1,615	3,567	1,309
Patents	3,740	1,689	3,591	1,363
Other identified intangible assets	877	238	838	100
Total	$ 12,468	$ 5,994	$ 12,263	$ 4,727

With the adoption of SFAS No. 142, the Company discontinued amortization of goodwill and other intangibles that were determined to have indefinite lives. Had amortization of goodwill and such other intangibles not been recorded in the fiscal year ended December 31, 2001, net income would have increased by $0.9 million, net of taxes, and diluted earnings per share would have increased by $0.01.

Intangible assets other than goodwill will continue to be amortized by the Company using estimated useful lives of 5 to 15 years and no residual values. Intangible amortization expense for the years ended December 31, 2003, 2002 and 2001 was approximately $1,267,000, $1,119,000 and

$840,000, respectively. Annual estimated amortization expense, based on the Company's intangible assets at December 31, 2003, is as follows:

Estimated Amortization Expense:		**(in thousands)**
Fiscal 2004	$	1,267
Fiscal 2005		1,267
Fiscal 2006		1,207
Fiscal 2007		851
Fiscal 2008		669

Changes in goodwill is as follows:

	Wholesale			**Retail**	
(in thousands)	**United States**	**Continental Europe**	**Other Countries**	**U.S. Retail Operations**	**Consolidated**
Balance, December 31, 2002	$ 1,574	$ —	$ 11,692	$ 8,204	$ 21,470
Additions/adjustments:					
Goodwill additions	—	—	—	371	371
Changes due to foreign exchange rates	—	—	2,768	—	2,768
Balance, December 31, 2003	$ 1,574	$ —	$ 14,460	$ 8,575	$ 24,609

Note 6—Accrued Liabilities

Accrued liabilities consist of the following:

	Years ended December 31,	
(in thousands)	**2003**	**2002**
Accrued employee compensation and benefits	$ 14,188	$ 9,708
Derivative liability	12,784	5,060
Other liabilities	10,012	9,569
	$ 36,984	$ 24,337

Note 7—Income Taxes

The Company's income before income tax provision was subject to taxes in the following jurisdictions for the years ended December 31:

(in thousands)	**2003**	**2002**	**2001**
United States	$ 50,101	$ 59,153	$ 59,382
Foreign	8,662	3,365	11,576
	$ 58,763	$ 62,518	$ 70,958

The provision for income taxes for the years ended December 31, consists of the following:

(in thousands)	2003	2002	2001
Current:			
Federal	$ 12,871	$ 20,075	$ 12,738
State	1,554	2,051	4,001
Foreign	4,469	1,390	4,734
	18,894	23,516	21,473
Deferred:			
Federal	2,322	(1,120)	(448)
State	3	79	(108)
Foreign	(652)	(594)	(330)
	1,673	(1,635)	(886)
	$ 20,567	$ 21,881	$ 20,587

No provision has been made for U.S. Federal, state or additional foreign income taxes which would be due upon the actual or deemed distribution of approximately $26.3 million of undistributed earnings of foreign subsidiaries as of December 31, 2003, which have been or are intended to be permanently reinvested.

A reconciliation of income tax expense computed at U.S. Federal statutory rates to income tax expense for the years ended December 31, is as follows:

(in thousands)	2003	2002	2001
Tax at U.S. Federal statutory rates	$ 20,567	$ 21,881	$ 24,835
State income taxes, net	1,012	1,384	2,530
U.S. export benefit, net of foreign tax rate differential	(1,256)	(1,268)	(6,957)
Other, net	244	(116)	179
	$ 20,567	$ 21,881	$ 20,587

There were no prepaid taxes included in deferred and prepaid income taxes at December 31, 2003. At December 31, 2002, deferred and prepaid income taxes included prepaid taxes of $74,000. The deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Significant components of the Company's deferred tax assets and liabilities at December 31, are as follows:

(in thousands)	2003	2002
Current deferred tax assets:		
Warranty reserve	$ 1,038	$ 1,123
Uniform capitalization	1,177	1,131
Sales returns reserve	2,016	1,706
State taxes	63	325
Inventory	1,932	1,864
Allowance for doubtful accounts	481	439
Accrued fringe benefits and compensation	1,720	1,301
Foreign tax credit	1,375	3,587
Other	944	(394)
Total current deferred tax assets	10,746	11,082
Long-term deferred tax liabilities:		
Depreciation and amortization	(7,788)	(5,853)
Other comprehensive income	3,884	(276)
Other	1,020	914
Total long-term deferred tax liability	(2,884)	(5,215)
Net deferred tax assets	$ 7,862	$ 5,867

Note 8—Debt

Line of Credit

In January 2001, the Company amended its unsecured line of credit with a bank syndicate which allows for borrowings up to $75 million and matures in August 2004. The amended line of credit bears interest at either LIBOR or IBOR plus 0.75% (1.86% at December 31, 2003) or the bank's prime lending rate minus 0.25% (3.75% at December 31, 2003). At December 31, 2003, the Company did not have any balance outstanding under such facility. The credit agreement contains various restrictive covenants including the maintenance of certain financial ratios. At December 31, 2003, the Company was in compliance with all restrictive covenants and financial ratios. The Company believes that it will be able to extend or replace its existing credit facility prior to its maturity without significant changes in terms. Certain of the Company's foreign subsidiaries have negotiated local lines of credit to provide working capital financing. These foreign lines of credit bear interest from 0.74% to 6.41%. Some of the Company's foreign subsidiaries have bank overdraft accounts that renew annually and bear interest from 2.66% to 13.5%. The aggregate borrowing limit on the foreign lines of credit and overdraft accounts is $24.1 million, of which $14.0 million was outstanding at December 31, 2003.

Long-Term Debt

The Company has a real estate term loan with an outstanding balance of $13.3 million at December 31, 2003, which expires in September 2007. The term loan, which is collateralized by the

Company's corporate headquarters, requires quarterly principal payments of approximately $380,000 ($1,519,000 annually), plus interest based upon LIBOR plus 1.00% (2.17% at December 31, 2003). In January 1999, the Company entered into an interest rate swap agreement that hedges the Company's risk of fluctuations in the variable rate of its long-term debt by fixing the interest rate over the term of the note at 6.31%. As of December 31, 2003, the fair value of the Company's interest rate swap agreement was a loss of approximately $1.0 million.

As of December 31, 2003, the Company also has a note payable in the amount of $1.4 million, net of discounts, in connection with the Iacon acquisition. Payments under the note are due in annual installments of $500,000 ending in 2006, with such payments contingent upon certain conditions.

The following schedule lists the Company's minimum annual principal payments on its long-term debt:

Year Ending December 31,		(in thousands)
2004	$	2,019
2005		2,019
2006		1,892
2007		8,731
2008		—
Thereafter		—
	$	14,661

Note 9—Commitments and Contingencies

Operating Leases

The Company is committed under noncancelable operating leases expiring at various dates through 2014 for certain offices, warehouse facilities, retail stores, production facilities and distribution centers. The following is a schedule of future minimum lease payments required under such leases as of December 31, 2003:

Year Ending December 31,		(in thousands)
2004	$	14,788
2005		14,020
2006		12,862
2007		11,583
2008		10,490
Thereafter		30,228
Total	$	93,971

Substantially all of the retail segment leases require the Company to pay maintenance, insurance, property taxes and percentage rent ranging from 5% to 8% based on sales volumes over certain minimum sales levels.

Rent expense for the years ended December 31, is summarized as follows:

(in thousands)	2003	2002	2001
Related Party	$ 90	$ 60	$ 48
Other	14,741	8,570	3,838
Total	$ 14,831	$ 8,630	$ 3,886

Additionally, during the years ended December 31, 2003, 2002 and 2001, the Company paid an officer and shareholder of the Company approximately $142,000, $42,000 and $170,000, respectively, for the placement of the Company's trademarks on, and related marketing activities in connection with, an automobile owned by the officer and shareholder that competes on the National Hot Rod Association drag racing circuit.

Purchase Commitments

The Company has an exclusive agreement through 2006, with its lens blank supplier and the supplier's French parent, pursuant to which the Company has the exclusive right to purchase decentered sunglass lenses, in return for the Company's agreement to fulfill all of its lens requirements, subject to certain exceptions, from such supplier.

Employment and Consulting Agreements

The Company has notified its officers of its decision not to extend the term of any existing employment agreement with its officers. In lieu of paying severance benefits pursuant to individual employment agreements, the Company has adopted two severance plans for the benefit of its officers that provide for, among other things, upon the termination of employment by the Company, (i) payment of a designated percentage of base salary and pro rata bonus; (ii) extension of Company-paid medical and benefits; and (iii) limited acceleration of vesting with respect to options. In addition, the Company entered into a severance agreement with one of its officers to provide for certain benefits in exchange for the cancellation of his employment agreement.

Endorsement Contracts

The Company has entered into several endorsement contracts with selected athletes and others who endorse the Company's products. The contracts are primarily of short duration. Under the contracts, the Company has agreed to pay certain incentives based on performance and is required to pay minimum annual payments as follows:

Year Ending December 31,		(in thousands)
2004	$	6,853
2005		2,844
2006		3
2007		2
2008		—
Thereafter		—
	$	9,702

Included in such amounts is an annual retainer of $0.5 million through 2005 for a former director of the Company.

Indemnities, Commitments 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 indemnities include indemnities to the Company's customers in connection with the sales of its products, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of the State of Washington. The Company has also issued a guarantee in the form of a standby letter of credit as security for contingent liabilities under certain workers' compensation insurance policies. The durations of these indemnities, commitments and guarantees vary. Some of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential 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.

Litigation

The Company is currently involved in litigation incidental to the Company's business. In the opinion of management, the ultimate resolution of such litigation, in the aggregate, will not likely have a material adverse effect on the accompanying consolidated financial statements.

Note 10—Derivative Financial Instruments

The Company is exposed to gains and losses resulting from fluctuations in foreign currency exchange rates relating to transactions of its international subsidiaries as well as fluctuations in its variable rate debt. As part of its overall strategy to manage the level of exposure to the risk of fluctuations in foreign currency exchange rates, the Company and its subsidiaries use foreign exchange contracts in the form of forward contracts. In addition, as part of its overall strategy to manage the level of exposure to the risk of fluctuations in interest rates, in January 1999, the Company entered into an interest rate swap agreement that results in fixing the interest rate over the term of the Company's ten-year real estate term loan. As of December 31, 2003, the fair value of the Company's interest rate swap agreement was a loss of approximately $1.0 million. At December 31, 2003, all of the Company's derivative were designated and qualified as cash flow hedges. For all qualifying and highly effective cash flow hedges, the changes in the fair value of the derivative are recorded in other comprehensive income. The Company is currently hedging forecasted foreign currency transactions that could result in reclassifications of $11.8 million of losses to earnings over the next twelve months. The Company hedges forecasted transactions that are determined probable to occur before the end of the subsequent fiscal year.

On the date the Company enters into a derivative contract, management designates the derivative as a hedge of the identified exposure. The Company does not enter into derivative instruments that do not qualify as cash flow hedges as described in SFAS No. 133. The Company formally documents all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking various hedge transactions. In this documentation, the Company specifically identifies the asset, liability, firm commitment or forecasted transaction that has been designated as a hedged item and states 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 it is determined that the derivative is no longer effective in offsetting change in the cash flows of a hedged item, (ii) when the derivative expires or is sold, terminated, or exercised, (iii) when the derivative is designated as a hedge instrument, because it is probable that the forecasted transaction 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 twelve months ended December 31, 2003, the Company recognized losses of $9.6 million, net of taxes, resulting from the expiration, sale, termination, or exercise of foreign currency exchange contracts.

The following is a summary of the foreign currency contracts outstanding by currency at December 31, 2003 (in thousands):

	U.S. Dollar Equivalent	Maturity	Fair Value (loss)
Forward Contracts:			
Australian dollar	$ 8,238	Jan. 2004 - Sep. 2004	$ (1,252)
British pound	26,369	Feb. 2004 - Dec. 2004	(2,160)
Canadian dollar	16,382	Jan. 2004 - Dec. 2004	(2,034)
Euro	33,983	Jan. 2004 - Dec. 2004	(4,246)
Japanese yen	14,009	Mar. 2004 - Dec. 2004	(1,227)
South African rand	4,071	Mar. 2004 - Dec. 2004	(897)
	$ 103,052		$ (11,816)

The Company is exposed to credit losses in the event of nonperformance by counterparties to its forward exchange contracts but has no off-balance-sheet credit risk of accounting loss. The Company anticipates, however, that the counterparties will be able to fully satisfy their obligations under the contracts. The Company does not obtain collateral or other security to support the forward exchange contracts subject to credit risk but monitors the credit standing of the counterparties. As of December 31, 2003, outstanding contracts were recorded at fair value and the resulting gains and losses were recorded in the consolidated financial statements pursuant to the policy set forth above.

Note 11—Shareholders' Equity

Stock Repurchase

In September 2002, the Company's Board of Directors authorized the repurchase of $20 million of the Company's common stock to occur from time to time as market conditions warrant. Under this program, as of December 31, 2003, the Company had purchased 829,600 shares of its common stock at an aggregate cost of approximately $8.6 million, or an average cost of $10.37 per share. Approximately $11.4 million remains available for repurchases under the current authorization.

Stock Incentive Plan

The Company's Amended and Restated 1995 Stock Incentive Plan (the "Plan") provides for stock-based incentive awards, including incentive stock options, nonqualified stock options, restricted stock, performance shares, stock appreciation rights and deferred stock to Company officers, employees, advisors and consultants. These shares are, in most cases, granted at an exercise price equal to the fair market value of the Company's stock at the time of grant. Options vest over periods ranging from one to four years and expire ten years after the grant date. A total of 8,712,000 shares have been reserved for issuance under the Plan. At December 31, 2003, stock options for 2,778,479 shares were exercisable and 2,095,398 shares were available for issuance pursuant to new stock option grants or other equity awards.

The following table summarizes information with respect to the Plan:

	Year ended December 31, 2003	2002	2001
Outstanding shares at January 1	3,905,227	3,495,306	3,005,047
Granted	1,080,697	702,250	1,126,000
Cancelled	(125,485)	(115,576)	(76,459)
Exercised	(52,419)	(176,753)	(559,282)
Outstanding shares at December 31	4,808,020	3,905,227	3,495,306
Exercisable shares at December 31	2,778,479	2,155,509	1,704,894
Average exercise price at January 1	$ 13.16	$ 12.49	$ 10.37
Granted	8.50	16.03	16.89
Cancelled	13.92	14.58	13.56
Exercised	9.38	10.20	9.82
Average exercise price at December 31	$ 12.14	$ 13.16	$ 12.49
Weighted average exercise price of exercisable options at December 31	$ 12.25	$ 11.67	$ 10.81
Weighted average fair value of options granted during the year	$ 3.07	$ 8.33	$ 7.64

Additional information regarding options outstanding as of December 31, 2003 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Avg Remaining Contractual Life (yrs)	Weighted Avg Exercise Price	Number Exercisable	Weighted Avg Exercise Price
$5.56-8.63	1,309,006	8.09	$ 8.04	354,356	$ 7.63
$9.06-11.00	948,561	5.14	$ 10.38	809,754	$ 10.35
$11.29-13.32	1,290,840	4.41	$ 12.05	1,051,707	$ 11.96
$14.04-25.10	1,259,613	7.54	$ 17.80	562,662	$ 18.44

During the years ended December 31, 2003, 2002 and 2001, the Company recorded stock compensation expense of $11,000, $3,000 and $98,000, respectively, associated with the fair value of stock options issued to non-employees.

Note 12—Employee Benefit Plan

The Company maintains a voluntary employee savings plan under Section 401(k) of the Internal Revenue Code (the "401(k) Plan") for all domestic employees with at least six months of service. The Plan is funded by employee contributions with the Company matching a portion of the employee contribution. Company contributions to the Plan were $0.8 million, $0.7 million and $0.7 million for the years ended December 31, 2003, 2002 and 2001, respectively, and are included in general and administrative expenses.

Note 13—Segment and Geographic Information

In the fourth quarter of 2003, the Company's retail business met the quantitative threshold for segment disclosure. As a result, the Company has revised its segment disclosure for the current and prior periods to reflect two reportable segments: wholesale and U.S. retail. The wholesale segment consists of the design, manufacture and distribution of the Company's products to wholesale customers in the U.S. and internationally, together with all direct consumer sales other than U.S. retail. The U.S. retail segment reflects the operations of the Company's specialty retail stores located throughout the United States, including the operations of its Iacon subsidiary. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance and allocates resources of segments based on net sales and operating income, which represents income before interest and income taxes. Segment net sales and operating income for the Company's wholesale operations include Oakley product sales to its subsidiaries at transfer price and other intercompany corporate charges. Segment net sales and operating income for the Company's U.S. retail operations include Oakley product sales to its Iacon subsidiary at transfer price, and sales to Oakley retail stores at cost. The U.S. retail segment operating income excludes any allocations for corporate operating expenses as these expenses are included in the wholesale segment.

Financial information for the Company's reportable segments is as follows:

	2003			
(in thousands)	**Wholesale**	**U.S. Retail**	**Inter-segment transactions**	**Total consolidated**
Net sales	$ 481,282	$ 53,206	$ (12,939)	$ 521,549
Operating income	55,917	4,266	(148)	60,035
Identifiable assets	405,688	40,280	(11,084)	434,884
Acquisitions of property and equipment	22,670	7,102	—	29,772
Depreciation and amortization	28,551	2,239	—	30,790

	2002			
	Wholesale	U.S. Retail	Inter-segment transactions	Total consolidated
Net sales	$ 464,953	$ 32,623	$ (8,024)	$ 489,552
Operating income	63,301	1,706	(846)	64,161
Identifiable assets	364,581	29,805	(10,436)	383,950
Acquisitions of property and equipment	25,796	7,196	—	32,992
Depreciation and amortization	27,140	1,438	—	28,578

	2001			
	Wholesale	U.S. Retail	Inter-segment transactions	Total consolidated
Net sales	$ 420,756	$ 8,885	$ (374)	$ 429,267
Operating income	72,992	1,346	(272)	74,066
Identifiable assets	351,844	20,026	(9,090)	362,780
Acquisitions of property and equipment	41,887	2,815	—	44,702
Depreciation and amortization	23,145	399	—	23,544

The following table sets forth sales by segment:

	2003		
	Wholesale	U.S. Retail	Total consolidated
Sales to third parties	$ 468,343	$ 53,206	$ 521,549
Inter-segment revenue	12,939	—	12,939
Gross sales	481,282	53,206	534,488
Less: eliminations	(12,939)	—	(12,939)
Total consolidated net sales	468,343	53,206	$ 521,549

	2002		
	Wholesale	U.S. Retail	Total consolidated
Sales to third parties	$ 456,929	$ 32,623	$ 489,552
Inter-segment revenue	8,024	—	8,024
Gross sales	464,953	32,623	497,576
Less: eliminations	(8,024)	—	(8,024)
Total consolidated net sales	456,929	32,623	$ 489,552

	2001		
	Wholesale	U.S. Retail	Total consolidated
Sales to third parties	$ 420,382	$ 8,885	$ 429,267
Inter-segment revenue	374	—	374
Gross sales	420,756	8,885	429,641
Less: eliminations	(374)	—	(374)
Total consolidated net sales	420,382	8,885	$ 429,267

Geographical regions representing 10% or more of consolidated net sales are summarized as follows:

	Year ended December 31,		
(in thousands)	**2003**	**2002**	**2001**
United States	$ 257,050	$ 254,024	$ 213,142
Continental Europe	91,473	81,879	72,301
Other international	173,026	153,649	143,824
Consolidated total net sales	$ 521,549	$ 489,552	$ 429,267

The Company's identifiable assets by geographical region are as follows:

	Year ended December 31,	
(in thousands)	**2003**	**2002**
United States	$ 294,663	$ 263,472
Continental Europe	44,233	38,834
Other international	95,988	81,644
Consolidated total identifiable assets	$ 434,884	$ 383,950

The Company derives revenues from different product lines within its segments. Gross sales from external customers for each product line are as follows:

(in thousands)	Year ended December 31, 2003	2002	2001
Sunglasses	$ 310,410	$ 330,154	$ 301,623
Apparel and accessories	76,018	56,625	37,886
Footwear	36,520	31,245	29,981
Watches	9,862	11,620	8,229
Prescription eyewear	42,669	34,253	24,726
Goggles	36,156	27,776	25,655
Other	48,957	37,108	22,263
Total gross sales	560,592	528,781	450,363
Discounts and returns	(39,043)	(39,229)	(21,096)
Total consolidated net sales	$ 521,549	$ 489,552	$ 429,267

Other consists of revenue derived from the sales of equipment, sunglass and goggle accessories and Iacon sales of sunglass brands other than the Company's.

Note 14—Restructure Charge

A restructure charge of $2.8 million ($1.8 million, or $0.02 per diluted share, on an after-tax basis) was recorded during the fourth quarter of fiscal 2002 to restructure (the "Restructuring Plan") the Company's European operations with significant changes to the regional sales and distribution organization. Pursuant to an approval of the Company's Board of Directors in December 2002, relationships with several outside sales agents have been modified or terminated, and changes have been implemented to rationalize other warehousing and distribution functions within the European markets. During 2003, the Company paid or settled almost all of the expenses associated with the Restructuring Plan. As of December 31, 2003, the Company had finalized all the restructuring charges and management believes the amount originally recorded will be sufficient to cover any remaining restructure liabilities.

This charge was included in selling and shipping and warehousing expenses and is comprised of the following components:

(in thousands)	Accrued restructure liability balance at Dec. 31, 2002	Amounts paid	Changes due to foreign exchange rates and adjustments	Balance as of Dec. 31, 2003
Termination and modification of sales agent contracts and employee contracts	$ 2,249	$ (1,960)	$ (31)	$ 258
Rationalization of warehousing and distribution	539	(864)	325	—
	$ 2,788	$ (2,824)	$ 294	$ 258

Note 15—Quarterly Financial Data (unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in thousands, except per share data)			
Year ended December 31, 2003:				
Net sales	$ 111,190	$ 143,841	$ 144,963	$ 121,555
Gross profit	59,415	87,970	82,492	64,826
Income before provision for income taxes	4,935	28,049	20,794	4,985
Net income	3,208	18,232	13,516	3,240
Basic net income per share	$ 0.05	$ 0.27	$ 0.20	$ 0.05
Diluted net income per share	$ 0.05	$ 0.27	$ 0.20	$ 0.05
Year ended December 31, 2002:				
Net sales	$ 109,572	$ 145,144	$ 131,913	$ 102,923
Gross profit	57,683	91,067	74,284	54,556
Income before provision for income taxes	9,217	34,545	19,272	1,127
Net income	5,562	22,334	12,254	487
Basic net income per share	$ 0.08	$ 0.32	$ 0.18	$ 0.01
Diluted net income per share	$ 0.08	$ 0.32	$ 0.18	$ 0.01

Oakley, Inc. and Subsidiaries
Schedule II—Valuation and Qualifying Accounts
For the Years Ended December 31, 2003, 2002, 2001

(in thousands)	Balance at beginning of period	Additions charged to costs and expense	Deductions	Adjustments	Balance at end of period
For the year ended December 31, 2003:					
Allowance for doubtful accounts	$ 2,606	$ 1,738	$ (1,721)	$ —	$ 2,623
Sales return reserve	$ 5,825	$ 4,707	$ (3,483)	$ —	$ 7,049
Inventory reserve	$ 7,158	$ 1,501	$ (1,409)	$ —	$ 7,250
For the year ended December 31, 2002:					
Allowance for doubtful accounts	$ 1,844	$ 1,877	$ (1,115)	$ —	$ 2,606
Sales return reserve	$ 4,111	$ 5,108	$ (3,394)	$ —	$ 5,825
Inventory reserve	$ 8,074	$ 1,630	$ (2,546)	$ —	$ 7,158
For the year ended December 31, 2001:					
Allowance for doubtful accounts	$ 1,512	$ 894	$ (562)	$ —	$ 1,844
Sales return reserve	$ 2,261	$ 4,789	$ (2,939)	$ —	$ 4,111
Inventory reserve	$ 6,756	$ 2,009	$ (691)	$ —	$ 8,074

Signatures

Pursuant to the requirements of Section 13 or 15(d) 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.

OAKLEY, INC.	
By:	/s/ JIM JANNARD

Date: March 5, 2004

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ JIM JANNARD	Chairman of the Board and CEO (Principal Executive Officer)	March 5, 2004
/s/ LINK NEWCOMB	Chief Operating Officer and Director	March 5, 2004
/s/ THOMAS GEORGE	Chief Financial Officer (Principal Accounting Officer)	March 5, 2004
/s/ ABBOTT BROWN	Director	March 5, 2004
/s/ LEE CLOW	Director	March 5, 2004
/s/ THOMAS DAVIN	Director	March 5, 2004
/s/ IRENE MILLER	Director	March 5, 2004

QuickLinks

Exhibit 10.39

AIRCRAFT LEASE

THIS LEASE made as of this 18th day of December, 2003 ("Lease") by and between N2T, Inc., an Oregon corporation ("Lessor"), and Oakley, Inc., a Washington corporation, with its principal offices located at One Icon, Foothill Ranch, CA 92610 ("Lessee").

1. LEASE OF THE AIRCRAFT

Subject to the terms and conditions contained herein, Lessor agrees to lease to Lessee and Lessee agrees to lease from Lessor that certain Global Express aircraft bearing manufacturers serial number 9010 and currently registered with the Federal Aviation Administration ("FAA") in the United States of America under registration number N701WH with two (2) Rolls Royce model BR710A2-20 engines, manufacturer's serial numbers 12121 and 12122, together with all accessories, parts, appliances, and appurtenances now or hereafter a part thereof, substitutions therefore, and repairs thereto (the "Aircraft").

2. DELIVERY OF AIRCRAFT

The Aircraft, together with all current and complete logs, books and records (including any computerized maintenance records) pertaining to the Aircraft and its maintenance in legible form, shall be delivered to Lessee at Hillsboro, Oregon or such other location as may be mutually agreed, on or about December 18, 2003. The date on which Lessee executes the Delivery and Acceptance Certificate in the form attached as Exhibit A hereto is referred to as the "Delivery Date."

3. TERM

The "Lease Term" shall commence on the Delivery Date and shall terminate on December 31, 2007 (or earlier in accordance with the next sentence). Lessee will have the right for any reason whatsoever to terminate this Lease before the end of the Lease Term, by giving Lessor not less than sixty (60) days' prior written notice of its intention so to terminate this Lease.

4. RENT

Notwithstanding Lessee's obligations to pay for the maintenance and operating costs of the Aircraft under Section 6, Lessee and Lessor hereby agree that no rent is due or payable under this Lease.

5. CERTAIN COVENANTS OF LESSEE

Lessee hereby covenants and agrees as follows:

(a)
Furnishing of Information

Lessee shall furnish from time to time to Lessor such information regarding Lessee's use, operation or maintenance of the Aircraft as Lessor may reasonably request.

(b)
Lawful Use

The Aircraft shall not be maintained, used, operated or stored in violation of any law or any rule, regulation or order of any government or governmental authority having jurisdiction (domestic or foreign), or in violation of any airworthiness certificate, license or registration relating to the Aircraft or its use, or in violation or breach of any representation or warranty made with respect to obtaining insurance on the Aircraft or any term or condition of such insurance policy. Aircraft operations shall be in compliance with Part 91 of Title 14 of the Code of Federal Regulations.

(c)
Aircraft Location

The Aircraft shall not be operated or located in (i) any area excluded from coverage by the terms of insurance or (ii) any recognized or threatened area of hostilities, unless fully covered to Lessor's satisfaction by war risk insurance.

(d)
Base of the Aircraft

The Aircraft shall be principally based at Hillsboro, Oregon or such other location as agreed to between Lessor and Lessee during the Lease Term and Lessee agrees to notify Lessor promptly of any change in the principal base.

(e)
Transportation Code Filings

Lessee shall, at its sole cost and expense, take all steps necessary to preserve and protect the U.S. registration of the Aircraft under the applicable provisions of Title 49 of the U.S. Code, and the rules and regulations promulgated thereunder.

(f)
Aircraft Operation

Lessee will be in operational control of the Aircraft at all times during the term hereof, and shall not sell, transfer, assign, encumber or, except with Lessor's prior written consent, sublet or part with such possession of the Aircraft or any of its rights under this Lease and shall be solely responsible for its possession, use and operation. Lessee shall bear all operating costs including, but not limited to: the cost of fuel, crew salaries, expenses and employee benefits; handling and custom fees and related charges; hangar and storage charges; insurance premiums for all insurance coverage required by this Lease; and all fines, fees or penalties arising directly or indirectly out of this Lease or Lessee's operation of the Aircraft.

(g)
Log Books

Lessee shall maintain all current and complete logs, books and records (including any computerized maintenance records) pertaining to the Aircraft and its maintenance during the Lease Term in accordance with FAA rules and regulations and Lessee shall, at the end of the Lease Term, deliver such records in legible form to Lessor.

(h)
Pilots

The Aircraft shall, at all times during the Lease Term, be operated by duly qualified, current, and rated (appropriate to the Aircraft) pilots paid and contracted for by Lessee and employed by Lessee, whose licenses are in good standing, who meet the requirements established and specified by the insurance policies required hereunder and by the FAA, and who have attended and successfully completed the manufacturer's approved training course for this type of Aircraft.

(i)
Alterations

Lessee shall not in any way alter, modify or make additions or improvements to the Aircraft, except as specifically required by Section 6 or under applicable laws or regulations, without the prior written consent of Lessor. All non- severable alterations, modifications, additions and improvements which are made shall become the property of Lessor and shall be subject to all the terms of this Lease.

(j)
Identification

Lessee shall keep a legible copy of this Lease in the Aircraft at all times.

(k)
Liens

Without the prior written consent of Lessor, Lessee will not directly or indirectly create, incur, assume or suffer to exist any liens on or with respect to (x) the Aircraft or any part thereof,

(y) Lessor's title thereto or (z) any interest of the Lessor therein, except (i) the respective rights of Lessor and Lessee as herein provided, (ii) Lessor Liens (as defined below), (iii) liens for taxes of Lessee either not yet due or being contested in good faith by appropriate proceedings so long as such proceedings do not involve any material danger of the sale, forfeiture or loss of the Aircraft, any risk of any material civil liability or any risk of criminal liability on the part of Lessor, (iv) material mens, mechanics', workmen's, repairmen's, employees' or other like liens arising in the ordinary course of Lessee's business (including those arising under maintenance agreements entered into in the ordinary course of business) securing obligations that are not overdue for a period of more than thirty (30) days or are being contested in good faith by appropriate proceedings so long as such proceedings do not involve any material danger of the sale, forfeiture or loss of the Aircraft or of any interest of Lessor therein, or any risk of criminal liability, (v) liens arising out of any judgment or award against Lessee not covered by insurance, unless the judgment secured shall not, within sixty (60) days after the entry thereof, have been discharged, vacated, reversed or execution thereof stayed pending appeal or shall not have been discharged, vacated or reversed within sixty (60) days after the expiration of such stay, and (vi) any other lien with respect to which Lessee shall have provided a bond, cash collateral or other security adequate in the reasonable opinion of Lessor. Lessee shall promptly, at its own expense, take (or cause to be taken) such actions as may be necessary to discharge duly any such lien not excepted above if the same shall arise at any time. "Lessor Liens" means any Lien arising as a result of (a) claims against Lessor not related to this Lease, (b) acts or omissions of Lessor not related to this Lease or in breach of any representation, warranty or covenant hereunder, (c) events or circumstances that occurred prior to the commencement of this Lease, (d) taxes, fees, charges and assessments that are not indemnified or payable by Lessee hereunder, or (e) any transfer, sale or assignment by Lessor of any interest in this Lease or the Aircraft.

(l)
Taxes

Lessee agrees to pay all property taxes, tolls, license fees or assessments, and landing fees (collectively, "Charges") which may be levied or assessed by any government against the Aircraft or the use thereof, in each case to the extent attributable to the period of the Lease Term. In addition, Lessee shall be liable to pay any retail sales or use tax that may be imposed on or with respect to the amount of the Fixed Rentals hereunder (a "Rental Tax"), but Lessee shall not be liable to pay any Rental Tax imposed or based on or with respect to any amount other than (i) the Fixed Rentals or (ii) in the case of Washington State retail sales tax, an assumed rental rate of approximately $7,000 per flight hour, and if Lessee is required to pay taxes above the amount Lessee is responsible for under this Section 5(1), Lessor is obligated to reimburse Lessee for the excess of the amount Lessee is responsible for under this Section 5(1). Lessee will reimburse Lessor for any such Charges and Rental Taxes which Lessor shall be required to pay; however, Lessee may contest any assessment of a Charge or a Rental Tax on Lessor and Lessor shall provide Lessee with a timely opportunity to defend against such assessment and cooperate in the defense thereof at Lessee's expense. Lessee shall, upon receipt of written request from Lessor, submit to Lessor evidence of Lessee's payment of any Charges and Rental Taxes due by Lessee.

6. AIRCRAFT MAINTENANCE

(a)
Maintenance

During the Lease Term and until such time as the Aircraft is returned to Lessor, Lessee agrees, at the direction of Lessor and at Lessee's expense, to cause the Aircraft to be maintained at all times in (A) fully operational, duly certified and airworthy condition and maintained in accordance with the manufacturer's recommended inspection program (FAR 91.409(f)(3)) and (B) condition adequate to comply with all regulations of the FAA or any other governmental agency having jurisdiction over the maintenance, use or operation of the Aircraft. Without limiting the foregoing, Lessee shall maintain, inspect, service and test the Aircraft and perform all repairs on the Aircraft in accordance with (i) all maintenance manuals for the Aircraft from time to time issued by the airframe manufacturer, the engine manufacturer or any other applicable manufacturer, (ii) all recommended service bulletins which might have a detrimental effect on the Aircraft airworthiness or safety of the Aircraft if not performed, and (iii) all airworthiness alerts and airworthiness directives issued by the FAA or any other governmental agency having jurisdiction. All work required by this Section 6(a) shall be undertaken and completed only by properly trained, licensed and certified maintenance personnel. All replacement parts shall be of the type approved by the airframe manufacturer, be of the same or better quality as the replaced part, and become the property of Lessor (free and clear of all liens and encumbrances other than the liens described in clauses (i) through (vi) of Section 5(k) hereof upon installation. Notwithstanding the foregoing, Lessor shall pay any extraordinary costs of maintenance or of complying with manufacturer's service bulletins or FAA airworthiness alerts and directives.

(b)
Rights Against Third Parties

Lessor hereby assigns to Lessee for the Lease Term all presently existing and future rights of Lessor against the manufacturer of, or service facility for, the airframe, engines, accessories, equipment and component parts of the Aircraft or any replacement thereof with respect to the obligation of said manufacturer or service facility under the warranties granted pursuant to the sale or servicing of such property. Lessee shall perform, and Lessor shall cooperate with Lessee to perform, all acts necessary to make a claim under any such warranty at Lessee's own expense.

7. INSPECTION

Lessor or its designee shall have the right, but not the duty, to inspect the Aircraft at any reasonable time and upon reasonable notice, provided that each such inspection shall be subject to Lessees safety and security rules applicable to the location of the Aircraft and no exercise of such inspection right shall interfere with the normal operation or maintenance of the Aircraft by Lessee or violate requirements of applicable insurance policies. Upon Lessor's request, Lessee shall advise Lessor of the Aircraft's location and, within a reasonable time and, provided there is no undue inconvenience and delay to Lessee, shall permit Lessor to examine all information, logs, documents and Lessee's records regarding or with respect to the Aircraft and its use maintenance or condition.

8. LOSS OR DAMAGE

(a)
Casualty Occurrences

In the event of a Casualty Occurrence, the Lease Term and Lessee's liability hereunder for any further Fixed Rentals shall terminate, and Lessor shall be entitled to recover possession of the Aircraft. Lessee shall immediately report a Casualty Occurence to Lessor and, as required by law, to governmental agencies. Lessor and Lessee shall proceed diligently and cooperate fully with each other to secure a recovery for any Casualty Occurrence. All proceeds of insurance referred to in Section 9 below, and/or all proceeds of any compensation in connection with the condemnation, confiscation, seizure or requisition of the Aircraft, applicable to a Casualty Occurrence shall be paid to Lessor. As used herein, a "Casualty Occurrence" shall mean any of the following events with respect to the Aircraft: (i) loss of the Aircraft or the use thereof due to the destruction, damage beyond repair or rendition of the Aircraft permanently unfit for normal use for any reason whatsoever; (ii) any damage to the Aircraft (including, but not limited to, anything requiring the completion of an FAA Form 337 "Major Repair and Alteration Statement") which results in an insurance settlement with respect to the Aircraft on the basis of a total loss; (iii) the theft or disappearance of the Aircraft which shall have resulted in the loss of possession of the Aircraft by Lessee for a period of five (5) consecutive days or more; or (iv) the condemnation, confiscation or seizure of, or the requisition of title to or use or possession of, the Aircraft for a period of five (5) consecutive days or more. A Casualty Occurrence with respect to the Aircraft shall be deemed to have occurred if a Casualty Occurrence occurs with respect to the airframe of such Aircraft.

(b)
Repairable Damage

If repairable damage occurs to the Aircraft or any part thereof that does not constitute a Casualty Occurrence, Lessee's obligation to pay rent under this Lease shall continue. To the extent necessary and appropriate, Lessee shall apply the proceeds of any insurance referred to in Section 9 below paid with respect to such damage to the repair of the Aircraft.

9. INSURANCE

(a)
Public Liability and Property Damage Insurance

Lessee represents and warrants that it will maintain in effect, at its own expense with insurers of recognized responsibility reasonably satisfactory to Lessor, (i) public liability insurance, including bodily injury and property damage (including, without limitation, passenger legal liability) in an amount not less than $200,000,000 for each single occurrence and (ii) such other property damage insurance (exclusive of manufacturer's property liability insurance) with respect to the Aircraft as is of the type and in the amounts usually carried by corporations similarly situated with Lessee, and owning or operating similar aircraft and engines and which covers risks of the kind customarily insured against by such corporations. Lessee shall provide at its own expense worker's compensation insurance with all-states coverage for the crew and maintenance personnel.

(b)
Insurance Against Loss or Damage to the Aircraft

Lessee represents and warrants that it will maintain in effect, at its own expense, with insurers of recognized responsibility reasonably satisfactory to Lessor, all-risk ground and flight aircraft hull insurance covering the Aircraft, including F.O.D. (foreign object damage), fire and explosion coverage, and lightning and electrical damage, and with respect to any Engines or Parts while removed from the Aircraft, and with respect to any engines or parts while temporarily installed on the Aircraft, provided that such insurance shall at all times while the Aircraft is subject to this Lease be for an amount of not less than the "Fair Market Value" of the Aircraft. For all purposes hereof, the Fair Market Value of the Aircraft shall be assumed to be $45,000,000, unless, at the request of either party, a valuation is obtained from a mutually agreed upon appraiser, in which event such appraised value shall be the Fair Market Value of the Aircraft. Lessee shall additionally maintain in effect, at its own expense, with insurers of recognized responsibility reasonably satisfactory to Lessor, war risk, hijacking (air piracy), governmental confiscation and expropriation insurance with respect to the Aircraft in a face amount of not less than the Fair Market Value for the Aircraft from time to time which shall be in full force and effect throughout any geographical areas at any time traversed by the Aircraft.

(c)
Insured Parties as Additional Insured; Notice

Any policies of insurance carried in accordance with this Section and any policies taken out in substitution or replacement for any such policies (i) shall name Lessor as an additional named insured as its interest may appear, (ii) with respect to insurance carried in accordance with paragraph (b) covering the Aircraft, shall be made payable (A) to Lessee, with respect to any damage to the Aircraft or any part thereof if such damage does not constitute a Casualty Occurrence, and shall be applied by Lessee to payment of the costs actually incurred with respect to repairs made to the Aircraft so as to restore it to the operating condition required by Section 6 hereof and any excess shall be disbursed as otherwise required by this Lease, or (B) to Lessor in the case of a Casualty Occurrence, (iii) shall provide that if the insurers cancel such insurance for any reason whatever, or any substantial change is made in the coverage which affects the interests of Lessor, or the same is allowed to lapse for nonpayment of premium or such insurance coverage is reduced, such cancellation, change, lapse or reduction shall not be effective as to Lessor for thirty (30) days following receipt by Lessor of written notice by such insurers of such cancellation, change, lapse or reduction and (iv) shall provide that in respect of the interest of Lessor in such policies the insurance shall not be invalidated by any action or inaction of Lessee or any other Person (other than Lessor) and shall insure Lessor's interest, as it appears, regardless of any breach or violation of any warranties, declarations or conditions contained in such policies by Lessee or any other Person (other than Lessor). Each insurance policy and its respective coverage amounts obtained in accordance with the requirements set forth in paragraphs (a) and (b) of this Section 9, (i) shall be primary without right of contribution from any other insurance which is carried by Lessor to the extent that such other insurance provides Lessor with contingent and/or excess liability insurance with respect to its interest as such in the Aircraft and (ii) shall expressly provide that all of the provisions thereof, except the limits of liability, shall operate in the same manner as if there were a separate policy covering each insured, and shall waive any right of the insurers to any set-off or counterclaim or any other deduction, by attachment or otherwise, in respect of Lessor or Lessee.

(d)
Reports, etc.

Lessee will advise Lessor in writing promptly of any default in the payment of any premium and of any other act or omission on the part of Lessee which might invalidate or render unenforceable, in whole or in part, any insurance on the Aircraft. Lessee will also advise Lessor in writing at least thirty (30) days prior to the expiration or termination date of any insurance carried and maintained on the Aircraft pursuant to this Section. In the event Lessee shall fail to maintain insurance as herein provided, Lessor may, at its option, provide such insurance, and Lessee shall, upon demand, reimburse Lessor for the cost thereof.

10. RETURN

(a)
Location

Upon the termination or expiration of the Lease Term, Lessee shall return the Aircraft, in accordance with Section 10(b), at Hillsboro, Oregon or at such other location within the 48 contiguous United States as may be agreed between Lessor and Lessee. All expenses for delivery and return of the Aircraft shall be borne by Lessee.

(b)
Return Condition

Upon return (other than a return upon a Casualty Occurrence where provisions of Section 8 shall apply) and at Lessee's expense (or at Lessor's expense as specified in Section 6(a)), the Aircraft must satisfy all of the following conditions:

(i)
The Aircraft must be in an airworthy and serviceable condition, meet all of the applicable regulations of the FAA, and have a valid and continuing FAA certificate of airworthiness;

(ii)
The Aircraft must be returned with all equipment, parts, components, passenger service items and other accessories that were on or in the Aircraft when delivered to Lessee in a serviceable condition (ordinary wear and tear excepted) or with an equivalent or better replacement thereof;

(iii)
All exterior paint and interior components (including, without limitation, paint, carpet, fabric and wood paneling) must be in the same good appearance as when the Aircraft was delivered to Lessee (ordinary wear and tear excepted), and any Lessee identification or logo in or on the Aircraft shall have been removed by Lessee;

(iv)
The Aircraft must be returned with all and complete originals of the logs, manuals, certificates, data, inspection, modification and overhaul records that were on or in the Aircraft when delivered to Lessee or are required to be obtained and maintained by Lessee hereunder (or if originals are not available, then any consequences of or

conditions to use of new logs and new maintenance records under FAA rules and regulations shall be observed or complied with), and all entries therein must be complete, correct and current, and in the case of any modifications made to, or supplemental type certificates incorporated in, the Aircraft, all engineering documents and drawings therefor must also be returned;*(v)*
The Aircraft shall undergo a reasonable inspection or inspections or a flight test or tests, as required in Lessor's discretion, resulting in Lessor's determination that the Aircraft and all parts, components, systems and records comply with FAA standards at that date and meet all of the above conditions.

If Lessee does not return the Aircraft in accordance with the above condition, (A) Lessor may make (or cause to be made) any repairs reasonably necessary to restore the Aircraft to the required condition, (B) Lessee shall reimburse Lessor, upon demand, for any costs, expenses and fees related to such restoration (including, without limitation, costs and expenses incurred as a result of actions pursuant to the parenthetical in clause (iv) above) and/or (C) Lessee shall compensate Lessor for the diminished value of the Aircraft resulting from Lessee's failure to return the Aircraft in such condition to Lessor's satisfaction.

If the parties hereto cannot agree on the diminished value of the Aircraft mentioned in the preceding clause (C) above, said value shall be established by using the average of the diminished value determined by two appraisals (each party appointing one appraiser) if these are within five percent (5%) of each other; if not, a third appraisal shall be done (the appraiser being appointed by the two preceding appraisers) and the average of the two closest appraisals shall be used.

11. REPRESENTATIONS AND WARRANTIES OF LESSEE

Lessee represents and warrants to Lessor as follows:

(a)
Due Organization

Lessee is a corporation duly organized and validly existing in good standing under the laws of the jurisdiction of its incorporation, is duly qualified to do business as a foreign corporation in good standing in each other jurisdiction where the conduct of its business requires it to be so qualified and a failure to be so qualified would have a material adverse affect on Lessees business or financial condition, is a "Citizen of the United States" within the meaning of Section 40102(a)(15) of Title 49 of the United States Code or any similar legislation of the United States of America enacted in substitution or replacement therefor, and has the corporate power and authority to enter into and perform its obligations under this Lease.

(b)
Due Authorization; Enforceability; No Violation

This Lease has been duly authorized by all necessary corporate action on the part of Lessee, does not require any approval of the stockholders of Lessee, has been duly executed and delivered by Lessee, and constitutes the legal, valid and binding obligation of Lessee, enforceable against Lessee in accordance with its terms. The execution and delivery by Lessee of this Lease, and the performance by Lessee of its obligations hereunder, will not be inconsistent with its charter or by-laws, do not and will not contravene any law, governmental rule or regulation, judgment or order applicable to or binding on Lessee, do not and will not contravene any provision of, or constitute a default or result in the creation of any lien (except Lessee's interest hereunder) under, any indenture, mortgage, contract or other instrument to which Lessee is a party or by which it is bound, and do not and will not require any approval or consent of any trustee or holders of indebtedness or obligations of Lessee, except such as have been duly obtained.

(c)
Government Approvals

No consent or approval of, giving of notice to, registration with, or taking of any other action in respect of or by, any federal, state or local governmental authority or agency (including. without limitation, the FAA or any similar agency) is required with respect to the execution, delivery and performance by Lessee of this Lease or the consummation of any of the transactions by Lessee contemplated hereby, or if any such approval, notice, registration or action is required, it has been duly given or obtained; except that as a condition to being able to operate the Aircraft, Lessee is required to, and shall, comply with Section 91.23(c) of Title 14 of the Code of Federal Regulations.

(d)
Location of Chief Executive Offices

The chief executive office or chief place of business (as either of such terms is used in Article 9 of the Uniform Commercial Code) of Lessee is located at its address set forth hereinabove, and Lessee agrees to give Less or prior written notice of any relocation of said chief executive office or chief place of business from its present location.

12. REPRESENTATIONS AND WARRANTIES OF LESSOR

Lessor represents and warrants to Lessee as follows:

(a)
Due Organization

Lessor is a corporation duly organized and validly existing in good standing under the laws of the jurisdiction of its incorporation, is duly qualified to do business as a foreign corporation in good standing in each other jurisdiction where the conduct of its business requires it to be so qualified and has the corporate power and authority to carry on its business and to enter into and perform its obligations under this Lease.

(b)
Due Authorization; Enforceability; No Violation

This Lease has been duly authorized by all necessary corporate action on the part of Lessor, does not require any approval of the stockholders of Lessor, has been duly executed and delivered by Lessor, and constitutes the legal, valid and binding obligation of Lessor, enforceable against Lessor in accordance with its terms. The execution and delivery by Lessor of this Lease, and the performance by Lessor of its obligations hereunder, will not be inconsistent with its charter or by-laws and will not contravene any law, governmental rule or regulation, judgment or order applicable to, or binding on, Lessor.

(c)
Undisclosed Defects

Lessor has no knowledge of undisclosed defects in the Aircraft.

13. LESSOR'S DISCLAIMER

EXCEPT AS SET FORTH ABOVE, LESSOR (AND ITS AFFILIATES) DOES NOT MAKE, HAS NOT MADE, NOR SHALL BE DEEMED TO MAKE OR HAVE MADE, ANY WARRANTY OR REPRESENTATION, EITHER EXPRESS OR IMPLIED, WRITTEN OR ORAL, WITH RESPECT TO THE AIRCRAFT LEASED HEREUNDER OR ANY ENGINE OR COMPONENT THEREOF, INCLUDING, WITHOUT LIMITATION, ANY WARRANTY AS TO DESIGN, COMPLIANCE WITH SPECIFICATIONS, QUALITY OF MATERIALS OR WORKMANSHIP, MERCHANTABILITY, FITNESS FOR ANY PURPOSE, USE OR OPERATION, AIRWORTHINESS, SAFETY, PATENT, TRADEMARK OR COPYRIGHT INFRINGEMENT, OR TITLE. All such risks, as between Lessor (and its affiliates) and Lessee, are to be borne by Lessee. Without limiting the foregoing, Lessor and its affiliates shall have no responsibility or liability to Lessee or any other person with respect to any of the following, regardless of any negligence of Lessor or its affiliates: (i) any liability, loss or damage caused or alleged to be caused, directly or indirectly by the Aircraft, any inadequacy thereof, any deficiency or defect (latent or otherwise) therein, or any other circumstance in connection therewith; (ii) the use, operation or performance of the Aircraft or any risks relating thereto, (iii) any interruption of service, loss of business or anticipated profits or consequential damages. or (iv) the delivery, operation, servicing, maintenance, repair, improvement or replacement of the Aircraft.

14. INDEMNIFICATION

(a)
General Indemnity

Lessee shall indemnify and save harmless Lessor, its affiliates, its successors and assigns, their directors, officers and employees (each, an "Indemnitee"), from and against any and all losses, claims (including. without limitation, claims involving strict or absolute liability in tort, damage, injury, death, liability and third party claims), suits, demands, costs and expenses of every nature (including, without limitation, reasonable attorneys' fees) arising directly or indirectly from or in connection with the possession, maintenance, condition, storage,use, operation or return of the Aircraft under this Lease (each, a "Claim"); *provided* , that the foregoing indemnity shall not extend to an Indemnitee with respect to any Claim to the extent such Claim is directly related to one or more of the following: (1) any breach of any representation or warranty by Lessor hereunder, or (2) the failure by Lessor to perform or observe any of its agreements, covenants or conditions herein, or (3) the willful misconduct or the gross negligence of any Indemnitee, or (4) the offer, sale or other disposition (voluntary or involuntary) of all or any part of Lessor's interest in the Aircraft or any part thereof, or (5) any tax, fee, Charge, or assessment or (6) except to the extent fairly attributable to the Lease Term, acts or events occurring, or circumstances or conditions existing, prior to, or after expiration or termination of, the Lease Term or actions taken (or required to be taken and not taken) prior to, or after expiration or termination of, the Lease Term or (7) any amount which Lessor expressly agrees to pay hereunder or any amount which is expressly stated to be a Claim that is not reimbursable by Lessee hereunder, or (8) any amounts relating to the deregistration with the FAA of the Aircraft as a result of the Lessor not being a Citizen of the United States. Lessee shall, upon request of Lessor, defend any actions based on or arising out of any of the Claims that Lessee is responsible for. Lessor shall not pay or settle any Claim without the prior written consent of Lessee, which shall not be unreasonably withheld or delayed, or conditioned (except on contest).

(b)
Survival

Lessee's obligations under this Section 14 shall survive termination of this Lease and shall remain in effect until all required indemnity payments have been made by Lessee to Lessor.

15. LESSEE'S DEFAULT

Each of the following events shall constitute an "Event of Default" hereunder:

(a) Lessee shall fail to make payment of any Aggregate Rental when due and such failure shall continue for five (5) business days after Lessor gives Lessee written notice of such failure; or

(b) Lessee shall fail to perform or observe any other covenant, condition or agreement to be performed or observed by it under this Lease or any agreement, document or certificate delivered by Lessee in connection herewith in any material respect, and such failure shall continue for thirty (30) days after written notice thereof from Lessor to Lessee; or

(c) Any representation or warranty made by Lessee in this Lease or any agreement, document, certificate delivered by the Lessee in connection herewith is or shall become incorrect in any material respect, and, if such a default is susceptible of being corrected, Lessee fails to correct such default with thirty (30) days of a written notice from Lessor requesting correction of same; or

(d) Lessee shall become insolvent or cease to do business as a going concern; or

(e) Lessee makes an assignment for the benefit of creditors, or if a petition is filed by or against Lessee under any bankruptcy or insolvency law; or

If a receiver is appointed for Lessee or any of Lessee's property.

16. LESSOR'S REMEDIES

(a)
Remedies

Upon the occurrence of any Event of Default, Lessor may, at its option, exercise any and or all remedies available at law or in equity, including, without limitation, any or all of the following remedies, as Lessor in its sole discretion shall elect:

(i)
By notice in writing terminate this Lease, whereupon all rights of Lessee to the use of the Aircraft or any part thereof shall absolutely cease and terminate but Lessee shall remain liable as hereinafter provided; and thereupon Lessee, if so requested by Lessor, shall at its expense promptly return the Aircraft as required by Section 10 hereof or Lessor, at its option, may, with or without legal process, enter upon the premises where the Aircraft may be located and take immediate possession of and remove the same. Lessee specifically authorizes Lessor's entry upon any premises where the Aircraft may be located for the purpose of, and waives any cause of action it may have arising from, a peaceful retaking of the Aircraft; and

(ii)
Perform or cause to be performed any obligation, covenant or agreement of Lessee hereunder. Lessee agrees to pay all costs and expenses incurred by Lessor for such performance as additional Aggregate Rental hereunder and acknowledges that such performance by Lessor shall not be deemed to cure said Event of Default.

(b)
Costs and Attorneys Fees

Lessee shall be liable for all costs, charges and expenses, including reasonable legal fees and disbursements, incurred by Lessor by reason of the occurrence of any Event of Default or the exercise of Lessor's remedies with respect thereto.

(c)
Nonexclusive

No remedy referred to herein is intended to be exclusive, but each shall be cumulative and in addition to any other remedy referred to above or otherwise available to Lessor at law or in equity. Lessor shall not be deemed to have waived any breach, Event of Default or right hereunder unless the same is acknowledged in writing by a duly authorized representative of Lessor. No waiver by Lessor of any default or Event of Default hereunder shall in any way be, or be construed to be, a waiver of any future or subsequent default or Event of Default. The failure or delay of Lessor in exercising any rights granted it hereunder upon any occurrence of any of the contingencies set forth herein shall not constitute a waiver of any such right upon the continuation or recurrence of any such contingencies or similar contingencies and any single or partial exercise of any particular right by Lessor shall not exhaust the same or constitute a waiver of any other right provided herein.

17. LESSOR'S ASSIGNMENT

It is understood that Lessor may assign or pledge any or all of its rights in this Lease or the Aircraft without notice to or the consent of Lessee. Any payments received by the assignee from Lessee with respect to the assigned portion of the Lease shall, to the extent thereof, discharge the obligations of Lessee to Lessor with respect to the assigned portion of the Lease.

18. NOTICES

Unless specifically provided to the contrary herein all notices permitted or required by this Lease shall be in writing and shall be deemed given when sent by telecopy or by nationally recognized courier service to the address set forth herein below, or such other address as may hereafter be designated by the addressee in a written notice to the other party.

19. ENTIRE AGREEMENT

The terms and conditions of this Lease constitute the entire agreement between the parties as to the subject matter hereof and supersede all prior written and oral negotiations, representations and agreements, if any, between the parties on such matters and shall be binding upon the parties, their successors, assigns and legal representatives.

20. MODIFICATION OF AGREEMENT

No change or modification hereof or waiver of any term or condition hereof shall be effective unless the change or modification is in writing and signed by both parties.

21. TIME OF THE ESSENCE

Time is of the essence in this Lease.

22. COUNTERPARTS

This Lease maybe executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

23. HEADINGS

The headings of Sections and subsections of this Lease (other than Section 25) are included for convenience only and shall not be used in its construction or interpretation.

24. GOVERNING LAW

THE PARTIES HERETO ACKNOWLEDGE THAT THIS LEASE SHALL BE GOVERNED BY AND CONSTRUED IN ALL RESPECTS IN ACCORDANCE WITH THE INTERNAL LAWS OF THE STATE OF NEW YORK INCLUDING, WITHOUT LIMITATION, SECTION 5-1401 OF THE NEW YORK GENERAL OBLIGATIONS LAW.

25. TRUTH-IN-LEASING

(a) LESSEE HAS REVIEWED THE AIRCRAFT'S MAINTENANCE AND OPERATING LOGS SINCE ITS DATE OF MANUFACTURE AND HAS FOUND THAT THE AIRCRAFT HAS BEEN MAINTAINED AND INSPECTED UNDER PART 91 OF THE FEDERAL AVIATION REGULATIONS DURING SUCH PERIOD. LESSEE CERTIFIES THAT THE AIRCRAFT PRESENTLY COMPLIES WITH THE APPLICABLE MAINTENANCE AND INSPECTION REQUIREMENTS OF PART 91 OF THE FEDERAL AVIATION REGULATIONS.

(b) LESSEE CERTIFIES THAT LESSEE, AND NOT LESSOR, IS RESPONSIBLE FOR OPERATIONAL CONTROL OF THE AIRCRAFT UNDER THIS LEASE DURING THE TERM HEREOF. LESSEE FURTHER CERTIFIES THAT LESSEE UNDERSTANDS ITS RESPONSIBILITY FOR COMPLIANCE WITH APPLICABLE FEDERAL AVIATION REGULATIONS.

(c) LESSEE CERTIFIES THAT THE AIRCRAFT WILL BE MAINTAINED AND INSPECTED UNDER PART 91 OF THE FEDERAL AVIATION REGULATIONS FOR OPERATIONS TO BE CONDUCTED UNDER THIS LEASE. LESSEE UNDERSTANDS THAT AN EXPLANATION OF FACTORS BEARING ON OPERATIONAL CONTROL AND PERTINENT FEDERAL AVIATION REGULATIONS CAN BE OBTAINED FROM THE NEAREST FAA FLIGHT STANDARDS DISTRICT OFFICE, GENERAL AVIATION DISTRICT OFFICE, OR AIR CARRIER DISTRICT OFFICE.

Notwithstanding the foregoing, any inaccuracy in any statement or certification in Section 25(a) shall not in and of itself constitute an indemnifiable Claim or an Event of Default hereunder.

IN WITNESS WHEREOF, the parties hereto have each caused this Lease to be duly executed as of the year and day first above written. THIS AGREEMENT SHALL NOT BE EFFECTIVE UNTIL EXECUTED ON BEHALF OF EACH PARTY.

LESSOR:		**LESSEE:**	
N2T, INC.		**OAKLEY, INC.**	
/s/ JIM JANNARD		/s/ LINK NEWCOMB	
By:	Jim Jannard	By:	Link Newcomb
Title:		Title:	Chief Operating Officer
Address:		Address:	One Icon Foothill Ranch, California 92610
Attention:	Jim Jannard	Attention:	Chief Operating Officer

Exhibit 10.40

INDEMNIFICATION AGREEMENT

This Indemnification Agreement is made as of this 12th day of February 2004, by and between OAKLEY, INC., a Washington corporation (the "Company"), and Tom Davin ("Indemnified Party").

WHEREAS, as of the date hereof, the Company has provisions for indemnification of its directors and officers in Article V of its Articles of Incorporation (the "Articles of Incorporation") and Article VII of its Amended and Restated Bylaws (the "Bylaws") which provide for indemnification of the Company's directors and officers to the fullest extent permitted by law;

WHEREAS, the indemnification provisions in the Bylaws provide that the right of indemnification is a contract right of the covered parties;

WHEREAS, the Bylaws provide that the Company may maintain, at its expense, insurance to protect itself and any of its directors and officers against liability asserted against such persons incurred in such capacity whether or not the Company has the power to indemnify such persons against the same liability under Section 23B.08.510 or .520 of the Act (as defined below) or a successor statute;

WHEREAS, the Company and the Indemnified Party recognize that the officers and directors of publicly owned companies are frequently joined as parties to Proceedings (as defined below) against their respective companies as a result of their serving in such capacity; and

WHEREAS, in order to induce Indemnified Party to serve or continue to serve the Company, the Company wishes to confirm the contract indemnification rights provided in the Bylaws and agrees to provide Indemnified Party with the benefits contemplated by this Agreement and to supplement the provisions of this Agreement with directors' and officers' liability insurance maintained by the Company.

NOW, THEREFORE, in consideration of the promises, conditions, representations and warranties set forth herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Company and Indemnified Party hereby agree as follows:

1. *Definitions*. The following terms, as used herein, shall have the following respective meanings; other capitalized terms used and not specifically defined in this Section 1 shall have the meanings provided elsewhere in the Agreement and in the Bylaws:

(a) "Act" means the Washington Business Corporation Act RCW Title 23B, as amended from time to time.

(b) "Adjudication" shall refer to a final, non-appealable decision by a court of competent jurisdiction. "Adjudged" shall have a correlative meaning.

(c) "Covered Amount" means any Loss, Fine and Expense, to the extent such Loss, Fine or Expense, in type or amount, is not insured under the D&O Insurance maintained by the Company from time to time.

(d) "Covered Act" means any act or omission of the Indemnified Party in his or her capacity as a director, officer, employee, agent, fiduciary or consultant of the Company alleged by any claimant or any claim against Indemnified Party by reason of him or her serving in such a capacity, or by reason of Indemnified Party serving, at the request of the Company, in such capacity with another corporation, partnership, employee benefit plan, trust or other enterprise, in all cases, whether such alleged act or omission occurred before or after the date of this Agreement.

(e) "D&O Insurance" means the liability insurance which the Company may purchase on behalf of Indemnified Party against liability asserted against or incurred by Indemnified Party in connection with claims arising from Covered Acts, whether or not the Company would have the power to indemnify the individual against the same liability under Section 23B.08.510 or 23B.08.520 of the Act.

(f) "Determination" means a determination, based on the facts known at the time, made:

(i) by the Board of Directors by majority vote of a quorum consisting of directors not at the time parties to the Proceeding;

(ii) if a quorum cannot be obtained under clause (i), by majority vote of a duly designated committee of the Board of Directors, in the manner provided by Section 23B.08.550(2)(b) of the Act;

(iii) by special legal counsel, selected in the manner provided by Section 23B.08.550(2)(c) of the Act, in a written opinion; or

(iv) by a majority of the shareholders of the Company, excluding shares owned or voted under the control of directors who are at the time parties to the Proceeding.

"Determined" shall have a correlative meaning.

(g) "Excluded Claim" means any payment for Losses, Fines or Expenses in connection with any claim relating to or arising out of:

(i) acts or omissions of the Indemnified Party Adjudged to be intentional misconduct or a knowing violation of law;

(ii) conduct of the Indemnified Party Adjudged to be in violation of Section 23B.08.310 of the Act; or

(iii) any transaction with respect to which it was Adjudged that such Indemnified Party personally received a benefit in money, property, or services to which the Indemnified Party was not legally entitled.

(h) "Expenses" means any reasonable expenses incurred by Indemnified Party as a result of a claim or claims made against Indemnified Party from Covered Acts, including, without limitation, reasonable counsel fees and costs of investigative, judicial or administrative proceedings or appeals.

(i) "Fines" means any fine or penalty including, with respect to an employee benefit plan, any excise tax assessed with respect thereto.

(j) "Losses" means amounts, as determined by an Adjudication, which the Indemnified Party is legally obligated to pay as a result of a claim or claims arising from Covered Acts, including, without limitation, Fines, damages and judgments and sums paid in settlement of such claim or claims.

(k) "Proceeding" means any threatened, pending or completed action, suit, proceeding or investigation, whether civil, criminal or administrative whether formal or informal.

2. *Maintenance of D&O Insurance.*

(a) The Company hereby covenants and agrees that, so long as Indemnified Party shall continue to serve as a director or executive officer of the Company and thereafter, for so long as Indemnified Party shall be subject to any possible Proceeding arising from any Covered Act, the Company, subject to Section 2(c), shall maintain in full force and effect D&O Insurance.

(b) In all policies of D&O Insurance, Indemnified Party shall be named as an insured in such a manner as to provide Indemnified Party the same rights and benefits, and the same limitations, as are accorded to the Company's directors or executive officers most favorably insured by such policy.

(c) The Company shall have no obligation to maintain D&O Insurance if the Company, by majority vote of the Board of Directors, determines in good faith that such insurance is not reasonably available, the premium costs for such insurance are disproportionate to the amount of coverage provided, or the coverage provided by such insurance is limited by exclusions so as to provide an insufficient benefit; *provided* , *however* , that such decision shall not adversely affect coverage of D&O Insurance for periods prior to such decision without the unanimous vote of all directors.

3. *Indemnification*. The Company shall indemnify Indemnified Party up to the Covered Amount and shall advance any and all Expenses to Indemnified Party in connection with any Proceeding or any Covered Act, subject, in each case, to the further provisions of this Agreement. This Agreement is made pursuant to and to effectuate the indemnification provisions set forth in Article V of the Articles of Incorporation and Article VII of the Bylaws. Notwithstanding any other provision of this Agreement, the Company shall indemnify Indemnified Party to the extent Indemnified Party is successful, on the merits or otherwise, in the defense of any Proceeding to which Indemnified Party was a party because of being a director, officer, employee, agent, fiduciary or consultant of the Company, against reasonable Expenses incurred by Indemnified Party in connection with the Proceeding.

4. *Excluded Coverage*. The Company shall have no obligation to indemnify Indemnified Party for any Losses or Expenses which arise from an Excluded Claim.

5. *Indemnification Procedures.*

(a) Promptly after receipt by Indemnified Party of notice of the commencement of or the threat of commencement of any Proceeding, Indemnified Party shall, if indemnification or advancement of Expenses with respect thereto may be sought from the Company under this Agreement, notify the Company of the commencement or the threat of commencement thereof.

(b) If, at the time of the receipt of such notice, the Company has D&O Insurance in effect, the Company shall give prompt notice of the commencement or the threat of commencement of such Proceeding to the appropriate insurers in accordance with the procedures set forth in the respective policies in favor of Indemnified Party. The Company shall thereafter take all necessary or desirable action to cause such insurers to, in accordance with the terms of such policies: (i) advance, to the extent permitted by law, any and all Expenses to Indemnified Party, (ii) pay, on behalf of Indemnified Party, all amounts (including, without limitation, Losses and Expenses) payable as a result of, or in connection with, such Proceeding and (iii) reimburse Indemnified Party for all amounts (including, without limitation, Losses and Expenses) paid by Indemnified Party as a result of, or in connection with, such Proceeding.

(c) To the extent the Company does not, at the time of the commencement of or the threat of commencement of such Proceeding, have applicable D&O Insurance, or if a Determination is made that any Loss, Fine or Expense of the Indemnified Party arising out of such Proceeding will not be payable under the D&O Insurance then in effect, the Company shall be obligated to pay the Covered Amount with respect to any Proceeding and to provide counsel satisfactory to Indemnified Party upon the delivery to Indemnified Party of written notice of the Company's election to do so. After delivery of such notice, the Company will not be liable to Indemnified Party under this Agreement for any legal or other Expenses subsequently incurred by the Indemnified Party in connection with such defense other than the reasonable Expenses of investigation of Indemnified Party; *provided* , that Indemnified Party shall have the right to employ his or her own counsel in connection with the defense of any such Proceeding, the fees and expenses of such counsel incurred after delivery of notice from the Company of its assumption of such defense to be at the Indemnified Party's sole expense. Notwithstanding the foregoing, if (i) the employment of counsel by Indemnified Party has been previously authorized by the Company, (ii) Indemnified Party shall have been advised by counsel that there may be a conflict of interest between the Company and Indemnified Party in the conduct of any such defense or (iii) the Company shall not, in fact, have employed counsel to assume the defense of such

Proceeding, in each such case, the fees and expenses of such counsel retained by Indemnified Party shall be at the expense of the Company. In the event Indemnified Party is entitled to employ counsel at the Company's expense pursuant to the terms of this Paragraph 5(c), and if so requested in writing by Indemnified Party, the Company shall advance any and all Expenses to Indemnified Party to the extent permitted by law.

(d) All payments on account of the Company's indemnification or advancement obligations under Paragraph 5(b) of this Agreement shall be made within sixty (60) days of Indemnified Party's written request therefor unless a Determination is made that the claims giving rise to Indemnified Party's request are Excluded Claims or otherwise not payable under this Agreement. All payments on account of the Company's obligations under Paragraph 5(c) of this Agreement shall be made within 20 days of Indemnified Party's written request therefor, subject to Paragraph 5(e) of this Agreement.

(e) In the event that (i) a Determination is made that the claims giving rise to Indemnified Party's request are Excluded Claims or otherwise not payable under this Agreement or (ii) it is Adjudged that the Indemnified Party is not entitled to be indemnified by the Company for Losses or Expenses under this Agreement, the Articles of Incorporation, the Bylaws or the Act, the Company shall have no obligation to indemnify, or advance any Expenses to Indemnified Party. Further, in either case, Indemnified Party agrees that he or she will reimburse the Company for all Losses and Expenses paid by the Company and all Expenses advanced by the Company in connection with such Proceeding against Indemnified Party.

6. *Settlement*. The Company shall have no obligation to indemnify Indemnified Party under this Agreement for any amounts paid in settlement of any Proceeding effected without the Company's prior written consent. The Company shall not settle any claim in any manner which would impose any loss or expense on Indemnified Party without Indemnified Party's prior written consent, unless the Company provides a written undertaking to the Indemnified Party to pay for such loss or expense on behalf of the Indemnified Party. Neither the Company nor Indemnified Party shall unreasonably withhold their consent to any proposed settlement.

7. *Rights Not Exclusive*. The rights provided hereunder shall be in addition to any other rights to which Indemnified Party may be entitled under the Articles of Incorporation, the Bylaws, the Act, any agreement or vote of shareholders or directors or otherwise, both as to action in Indemnified Party's official capacity and as to action in any other capacity, and such rights shall continue after Indemnified Party ceases to serve the Company as a director or officer.

8. *Enforcement.*

(a) Indemnified Party's rights to indemnification or advancement of Expenses hereunder shall be enforceable by Indemnified Party notwithstanding any adverse Determination. In any such action, if a prior adverse Determination has been made, the burden of proving that indemnification or advancement of Expenses is required under this Agreement, the Articles of Incorporation, the Bylaws or the Act shall be on the Indemnified Party. The Company shall have the burden of proving that indemnification or advancement of Expenses is not required under this Agreement if no prior adverse Determination shall have been made.

(b) In the event that any action is instituted by Indemnified Party under this Agreement, or to enforce or interpret any of the terms of this Agreement, Indemnified Party shall be entitled to be paid all court costs and expenses, including reasonable counsel fees, incurred by Indemnified Party with respect to such action, unless the court determines that each of the material assertions made by Indemnified Party as a basis for such action were not made in good faith or were frivolous.

9. *No Presumptions*. For purposes of this Agreement, the termination of any Proceeding by judgment, order, settlement (whether with or without court approval) or conviction, or upon a plea of nolo contendre, or its equivalent, shall not create a presumption that the Indemnified Party did not meet any particular standard of conduct or have any particular belief or that a court has determined that indemnification or advancement of Expenses by the Company is not permitted hereunder or by applicable law. In addition, neither the absence of a Determination as to whether Indemnified Party has met any particular standard of conduct or had any particular belief or the existence of a Determination that Indemnified Party has not met such standard of conduct or did not have such belief, prior to the commencement of legal proceedings by Indemnified Party to secure an Adjudication that Indemnified Party should be indemnified or advanced or reimbursed Expenses hereunder or under applicable law, shall be a defense to Indemnified Party's claim or create a presumption that Indemnified Party has not met any particular standard of conduct or did not have any particular belief.

10. *Subrogation*. In the event of payment under this Agreement, the Company shall be subrogated to the extent of such payment to all of the rights of recovery of Indemnified Party, who shall execute all papers required and shall do everything that may be necessary to secure such rights, including the execution of such documents necessary to enable the Company to effectively bring suit to enforce such rights.

11. *No Duplication of Payments*. The Company shall not be liable under this Agreement to make any payment in connection with any Proceeding against Indemnified Party to the extent Indemnified Party has otherwise actually received payment (under any D&O Insurance, the Articles of Incorporation, the Bylaws, the Act or otherwise) of the amounts which may be paid hereunder.

12. *Severability*. In the event that any provision of this Agreement is determined by a court of competent jurisdiction to require the Company to do or to fail to do an act which is in violation of the Articles of Incorporation, the Bylaws or the Act or other applicable law, such provision shall be limited or modified in its application to the minimum extent necessary to avoid such violation, and, as so limited or modified, such provision and the remainder of this Agreement shall be enforceable in accordance with the respective terms.

13. *Choice of Law*. This Agreement shall be governed by, construed and enforced in accordance with the laws of the State of Washington, without reference to conflicts of law principles therein.

14. *Successors and Assigns*. This Agreement shall be (i) binding upon all successors and assigns of the Company (including any transferee of all or substantially all of the Company's assets and any successor by merger or otherwise by operation of law) and (ii) binding on and inure to the benefit of the heirs, personal representatives and estate of Indemnified Party. Indemnified Party may not assign this Agreement or any of Indemnified Party's rights hereunder without the prior written consent of the Company.

15. *Amendment*. No amendment, modification, termination or cancellation of this Agreement shall be effective unless made in a writing signed by each of the parties hereto.

xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx

IN WITNESS WHEREOF, the Company and Indemnified Party have executed this Indemnification Agreement as of the date first above written.

		OAKLEY, INC.		
		By:		/s/ LINK NEWCOMB
		Name:		Link Newcomb
		Title:		COO

		/s/ TOM DAVIN

QuickLinks
INDEMNIFICATION AGREEMENT

Exhibit 21.1

Oakley, Inc.
List of Material Subsidiaries

Bazooka, Inc.

QuickLinks -- Click here to rapidly navigate through this document

Exhibit 23.1

Independent Auditors' Consent

We consent to the incorporation by reference in Registration Statement Nos. 33-98690 and 333-07191 of Oakley, Inc. on Form S-8 of our report dated March 4, 2004 (which report expresses an unqualified opinion and includes an explanatory paragraph relating to a change in accounting for goodwill and other intangible assets during 2002), appearing in this Annual Report on Form 10-K of Oakley, Inc. for the year ended December 31, 2003.

/s/ DELOITTE & TOUCHE LLP
Costa Mesa, California
March 4, 2004

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Exhibit 31.1

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jim Jannard, certify that:*1.*
I have reviewed this Annual Report on Form 10-K of Oakley, Inc.;

2.
Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.
Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.
The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a)
Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b)
Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c)
Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.
The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a)
All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b)
Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 5, 2004		/s/ JIM JANNARD

QuickLinks
Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

QuickLinks -- Click here to rapidly navigate through this document

Exhibit 31.2

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Thomas George, certify that:*1.*
I have reviewed this Annual Report on Form 10-K of Oakley, Inc.;

2.
Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.
Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.
The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a)
Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b)
Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c)
Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.
The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a)
All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b)
Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 5, 2004		/s/ THOMAS GEORGE

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Exhibit 32.1

Certification of CEO and CFO Pursuant to
18 U.S.C. Section 1350,
as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Annual Report on Form 10-K of Oakley, Inc. (the "Company") for the annual period ending December 31, 2003 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Jim Jannard, as Chief Executive Officer of the Company, and Tom George, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to Oakley, Inc. and will be retained by Oakley, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

/s/ JIM JANNARD		

/s/ THOMAS GEORGE Name: Thomas George		


GMT
WHEN THEY NEEDED
FOOTWEAR
THEY CAME TO US.

CORPORATE INFORMATION

Board of Directors

JIM JANNARD
Chairman, Chief Executive Officer

LINK NEWCOMB
Chief Operating Officer

IRENE MILLER
Chief Executive Officer, Akim, Inc.,
Advisory Director, Intralinks, Inc.
Former Vice Chairman and
Chief Financial Officer,
Barnes & Noble, Inc.

ABBOTT BROWN
Chairman and
Chief Executive Officer,
Ridgestone Corporation

LEE CLOW
Chairman and
Worldwide Creative Director,
TBWA\Chiat\Day

TOM DAVIN
Operating Partner, Brentwood Associates,
Chairman, Spectrum Clubs, Inc.,
Director, Zumiez, Inc.,
Former Chief Operating Officer, Taco Bell Corporation,
Former USMC Captain

Corporate Officers

JIM JANNARD
Chairman, Chief Executive Officer

LINK NEWCOMB
Chief Operating Officer, Director

COLIN BADEN
President

TOMMY RIOS
Executive Vice President

THOMAS GEORGE
Chief Financial Officer

DONNA GORDON
Vice President of Finance,
Secretary

KENT LANE
Vice President of Manufacturing

CARLOS REYES
Vice President of Development

SCOTT BOWERS
Vice President of Marketing Worldwide

JON KRAUSE
Vice President of Operations

CLIFF NEILL
Vice President of U.S. Sales

Corporate Offices

Oakley, Inc.
One Icon
Foothill Ranch,
California
92610 USA
1 800 403 7449

Oakley Africa
Oakworth Drive, Humewood
Port Elizabeth 6001
South Africa
+27 41 501 0200

Oakley Canada
2660 Diab St-Laurent
Quebec H4S 1E8
1 800 448 9714

Oakley Europe
Immeuble Cap West
15 allée de l'Europe
92588 Clichy Cedex
France
+33 1 41 27 81 81

Oakley Japan
MT2 Bldg., 1-12-23 Mita
Meguro-ku, Tokyo 153-0062
+81 3 3716 9300

Oakley Mexico Inc., S.A. DE C.V.
Camino Cuajimalpa - Palo Solo #7
Col. Hacienda de las Palmas
Huixquilucan, Edo. de Mexico
C.P. 52765
+52 5 247 0310

Oakley South Pacific
Level 4, 49-51 Malop Street
Geelong Victoria 3220
Australia
+61 3 5225 4100

Oakley U.K. Ltd.
Icon House Icknield Way
Letchworth Garden City
Herts SG6 1GD
United Kingdom
+44 1462 475 400

Oakley GMBH
Carl-Zeiss-Ring 7A
D-85737 Ismaning
Germany
+49 89 99650 4100

Oakley Brasil
Cidade Jardim
São Paulo - SP
05670-000 Brasil
+55 11 3038 9999

Annual Meeting

Shareholders are cordially invited to attend
Oakley's 2004 Annual Meeting to be held at
Oakley Corporate Headquarters,
One Icon,
Foothill Ranch, CA 92610,
June 4, 2004 at 10:00am

Transfer Agent Registrar

American Stock
Transfer & Trust Company
59 Maiden Lane
New York, NY 10038
212 936 5100

Auditors

Deloitte & Touche LLP
Costa Mesa, CA

Legal Counsel

Skadden, Arps, Slate, Meagher & Flom
Los Angeles, CA

Weeks, Kaufman, Nelson & Johnson
Solana Beach, CA

Investor Relations

PondelWilkinson MS&L
Los Angeles, CA

Shareholder Inquiries

Inquiries from shareholders and investors regarding the Company are always welcome. Copies of the Company's 10–K (Annual Report), 10–Q (Quarterly Reports) and other Securities and Exchange Commission (SEC) filings are available to shareholders by written request to:

Oakley, Inc. Investor Relations
One Icon
Foothill Ranch, CA 92610 USA
1.800.403.7449 or by visiting the Company's website:
www.oakley.com

Securities Listing

Oakley, Inc. common stock is listed on the New York Stock Exchange under the trading symbol the "OO."