2011 Annual Report
Notice of 2012 Annual Meeting &
Proxy Statement

Letter to Stockholders

This marks the first year in quite some time that sales actually increased. While that increase was small, we believe it's a definitive step in the right direction. To this end, one thing stands out above all others: kids' passion for and awareness of Heelys is as strong as it's ever been. Kids know us. Kids want us. Our single biggest challenge going forward will be gaining retail distribution to bridge the gap between kids and their desire for Heelys, and their ability to find us at retail. That's our focus short term, and as the global economy works to right itself, we continue to work to capitalize on new products and new efficiencies to ride that wave as it builds.

Cost cutting continues where it makes sense and doesn't harm our ability to execute on sales and growth strategies. We've made further cuts in legal costs by refocusing our patent infringement efforts on downstream retail and landlord targets as opposed to small manufacturers who are hard to catch, and even harder to collect from. Outside the US, we're taking the same tact in working to stop larger infringers who are shipping product into key markets. With this new approach, more impact has been made with fewer resources expended. We've also made other staff cuts including the recent announcement (March 2012) that we will close our International Headquarters office in Brussels as part of a global restructuring designed to concentrate resources closer to our customers. Marketing and customer service responsibilities will be assigned to our sales offices in Annecy, Munich and Tokyo with most administrative functions returning to our offices in Carrollton, Texas.

On the revenue side, we have evolved our media/marketing strategy to emphasize more direct and measureable efforts online, in store and through social media. Again, we're trying to get closer to our retailers and our end users by putting more attention on more intimate forms of messaging and media as well as working to increase brand impact in stores at the point of purchase. Our efforts through bloggers, search engine optimization and live events continue to pick up momentum and bring great awareness and desire for our products. One fact we consider a leading indicator is the significant increase we saw in online sales in 2011, with special emphasis on Q4. We see this increase in demand online as more than just a trend toward electronic purchasing, we believe that it's also a clear indicator that desire for Heelys is not being met through our current level of bricks and mortar distribution…which simply increases our resolve to tell this demand story to prospective retailer partners and drive closer to our optimum goal of 3500 doors in the US.

The same holds true for our international markets. We continue to end relationships with underperforming distributors and seek out enthusiastic, professional, well funded partners to represent us in foreign markets. While most of these changes began in late 2011, they will show results as we move through late 2012 and early 2013, and these new partners begin to order product and start the process of selling in.

This year also saw the introduction of a new brand, Sidewalk Sports. Launched in Q4, the brand was available exclusively at Kmart. Sidewalk Sports was designed to answer moms' questions and concerns about the amount of money they would be willing to "risk" on a purchase for their younger kids. "Would they like it? Would they be able to do it?" Certainly valid questions that had to be addressed. The ease of use of our two wheeled product, combined with what moms told us was a "tolerable" risk price of $29.95 (suggested retail price), has proven to be a powerful combination in answering those questions and driving trial at the younger end of our demographic. We believe that Sidewalk Sports will very effectively widen the top of the funnel for us at the very youngest end of our target. That demographic refreshes at about 10 percent annually providing an evergreen opportunity for new fans and an increase in repeat purchases. Our plan is to introduce Sidewalk Sports into other retailers this year both in the US and internationally where we also believe that the brand will serve as a great "knock off" fighter due our ability to offer its superior quality at a similar price.

So as we move forward into 2012, our focus remains on two primary tasks: driving quality bricks and mortar distribution and increasing brand visibility both in the US and internationally. We continue to look for new partners, projects and potential acquisitions that would help us grow our brands and our business.

As always, we want to thank our board, our shareholders, our vendor, partners and employees worldwide for the attention, patience, support and efforts this year on behalf of the Heelys brand.

Sincerely,

Thomas C. Hansen
President and Chief Executive Officer

Gary L. Martin
Chairman of the Board

3200 Belmeade Drive, Ste 100
Carrollton, TX 75006
www.heelys.com

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD JUNE 7, 2012

To the Stockholders of Heelys, Inc.:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of Heelys, Inc. will be held on Thursday, June 7, 2012 at 10:00 a.m. Central Daylight Saving Time at the Crowne Plaza Hotel, 14315 Midway Road, Addison, Texas 75001, for the following purposes:

1. To elect eight directors to hold office until the 2013 annual meeting of stockholders.

2. To ratify the appointment of Grant Thornton LLP to serve as our independent registered public accounting firm for the fiscal year ending December 31, 2012.

3. To take action on any other business that may properly come before the meeting and any adjournment or postponement thereof.

Only stockholders who owned our common stock at the close of business on April 12, 2012 can vote at this meeting or any adjournment or postponement that may take place.

All stockholders are cordially invited to attend the meeting in person. However, to assure your representation at the meeting, you are urged to mark, sign and return the enclosed proxy as promptly as possible in the postage-prepaid envelope for that purpose. If you later desire to revoke your proxy for any reason, you may do so in the manner provided in the attached proxy statement. Your stock will be voted in accordance with the instructions you have given. You will find more instructions on how to vote in the attached proxy statement.

By order of the Board of Directors,

Barbara A. Nagy
Corporate Secretary

Carrollton, Texas
April 13, 2012

Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to be Held on June 7, 2012:

This Notice of Annual Meeting, Proxy Statement and the accompanying Annual Report to Stockholders are available on our website at http://investors.heelys.com

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PROXY STATEMENT
FOR ANNUAL MEETING OF STOCKHOLDERS

This Proxy Statement is furnished in connection with the solicitation of proxies from the holders of shares of voting common stock of Heelys, Inc. to be voted at our 2012 Annual Meeting of Stockholders (the "Annual Meeting") to be held on June 7, 2012, at 10:00 a.m. Central Daylight Saving Time, at the Crowne Plaza Hotel, 14315 Midway Road, Addison, Texas 75001.

The enclosed proxy is solicited by the Board of Directors of the Company (the "Board"). These proxy materials have been prepared by our management for our Board. This Proxy Statement, the proxy card and our Annual Report are first being mailed to stockholders entitled to vote at the meeting on or about May 4, 2012.

The mailing address of our principal executive office is 3200 Belmeade Drive, Ste 100, Carrollton, Texas 75006.

The terms "we," "our," "us," "Heelys" or the "Company" refer to Heelys, Inc. and its subsidiaries.

GENERAL INFORMATION

What is the purpose of the meeting?

At our Annual Meeting, stockholders will act on the matters disclosed in the Notice of Annual Meeting of Stockholders that preceded this Proxy Statement. There are two proposals scheduled to be voted on at the meeting:

- elect eight directors; and
- ratify the appointment of Grant Thornton LLP to serve as our independent registered public accounting firm.

We will also consider any other business that may be properly presented at the meeting and respond to questions from stockholders.

Our Board is asking you to vote on the proposed items of business. This Proxy Statement and form of proxy, along with our Annual Report, are first being sent to stockholders on or about May 4, 2012.

How does the Board recommend that I vote?

The Board recommends a vote:

- FOR all of the nominees for director; and
- FOR the ratification of the appointment of Grant Thornton LLP to serve as our independent registered public accounting firm for the fiscal year ended December 31, 2012.

Who is entitled to vote at the meeting?

The Board has set April 12, 2012 as the record date for the meeting. If you were a stockholder of record at the close of business on April 12, 2012, you are entitled to vote at the meeting. You have one vote for each share of common stock you held on the record date.

As of the record date, 27,571,052 shares of Heelys common stock were outstanding. Heelys does not have any other class of capital stock outstanding.

How many shares must be present to hold the meeting?

A quorum is necessary to hold the meeting and conduct business. The presence, either in person or represented by proxy, of stockholders who can direct the vote (with respect to the election of directors) of at least a majority of the outstanding shares of common stock as of the record date is considered a quorum. A stockholder is counted present at the meeting if:

- the stockholder is present and votes in person at the meeting; or
- the stockholder has properly submitted a proxy.

Shares that are not voted by the broker who is the record holder of the shares because the broker is not instructed to vote and does not have discretionary authority to vote (i.e., broker non-votes) and shares that are not voted in other circumstances in which proxy authority is defective or has been withheld, will be counted for purposes of establishing a quorum.

If a quorum is not present, the annual meeting will be adjourned until a quorum is obtained.

What is the difference between a stockholder of record and a "street name" holder?

If your shares are registered directly in your name, you are considered the stockholder of record with respect to those shares.

If your shares are held in a stock brokerage account or by a bank or other nominee, you are still considered the beneficial owner of the shares, but your shares are held in "street name."

How do I vote my shares?

If you are a stockholder of record, you can vote your shares without having to attend the meeting by providing a proxy. This can be done by mailing your signed proxy card to us before the meeting. You may also vote in person at the meeting.

If you hold your shares in street name, you must vote your shares following the procedures indicated to you by your broker or nominee on the enclosed voting instruction card.

What if multiple stockholders have the same address?

If you and other residents at your mailing address own shares of common stock in street name, your broker or bank may have sent you a notice that your household will receive only one annual report and proxy statement. This practice is known as "householding," and is designed to reduce our printing and postage costs. However, if any stockholder residing at such an address wishes to receive a separate annual report or proxy statement, he or she may send a request to our Corporate Secretary or by calling toll free at 866-433-5464.

What does it mean if I receive more than one proxy card?

It means you hold shares registered in more than one account. To ensure that all of your shares are voted, sign and return each proxy card you receive. If you wish to consolidate your accounts, please contact our stock transfer agent, American Stock Transfer & Trust Company, LLC, 6201 - 15th Avenue, Brooklyn, New York 11219 or by telephone at either 718-921-8200 or toll-free at 800-937-5449.

In addition to a proxy card, you may also receive a "voting instructions" card which looks very similar to a proxy card. Voting instructions are prepared by brokers, banks or other nominees for stockholders who hold shares in street name.

Can I vote my shares in person at the meeting?

Yes. If you are a stockholder of record, you may vote your shares at the meeting by completing a ballot at the meeting. However, even if you currently plan to attend the meeting, we recommend that you submit your proxy ahead of time so that your vote will be counted if, for whatever reason, you later decide not to attend the meeting.

If you hold your shares in street name, you may vote your shares in person at the meeting only if you obtain a signed proxy from your broker, bank or other nominee giving you the right to vote such shares at the meeting.

What vote is required to elect directors?

Directors are elected by a plurality of votes cast. This means that the eight nominees receiving the highest number of "FOR" votes from our shares entitled to vote, present in person or represented by proxy, will be elected, provided that a quorum is present at the meeting.

What vote is required on proposals other than the election of directors?

With respect to each item of business to be voted on at the meeting, other than the election of directors, the affirmative vote of a majority of the shares present in person or represented by proxy at the meeting that are entitled to vote with respect to that item is required for the approval of the item.

What are broker non-votes?

If your shares are held by a broker, the broker may require your instructions in order to vote your shares. If you give the broker instructions, your shares will be voted as you direct. If you do not give instructions, your shares will be considered to be "broker non-votes" and will not be voted on any proposal on which your broker does not have discretionary authority to vote.

Broker non-votes and other non-voted shares will not be deemed to be entitled to vote for purposes of determining whether stockholder approval of that matter has been obtained and thus will have no effect on the outcome of such matter.

How are votes counted?

Stockholders may either vote "FOR" or "WITHHOLD" authority to vote for the nominees for the Board. Stockholders may also vote "FOR," "AGAINST" or "ABSTAIN" on the other proposals.

If you vote ABSTAIN or WITHHOLD, your shares will be counted as present at the meeting for the purposes of determining a quorum.

If you ABSTAIN from voting on the proposals, your abstention has the same effect as a vote against those proposals. If you WITHHOLD authority to vote for one or more of the directors, this has the same effect as a vote against the director or directors for which you WITHHOLD your authority.

If you hold your shares in street name and do not provide voting instructions to your broker, they will be counted as present at the meeting for the purpose of determining a quorum but will not be voted on any proposal on which your broker does not have discretionary authority to vote.

What if I do not specify on my proxy card how I want my shares voted?

If you do not specify on your returned proxy card how you want to vote your shares, the proxies will vote them as recommended by our Board:

- FOR the election of all of the nominees for director; and
- FOR the ratification of the appointment of Grant Thornton LLP to serve as Heelys' independent registered public accounting firm for the fiscal year ended December 31, 2012.

Can I change my vote?

Yes. You may change your vote and revoke your proxy at any time before it is voted at the meeting in any of the following ways:

- by delivering a written notice of revocation to Heelys' Corporate Secretary;
- by submitting another properly signed proxy card at a later date to our Corporate Secretary; or
- by attending and voting in person at the Annual Meeting.

Attendance at the Annual Meeting will not, by itself, revoke a proxy.

Who pays the cost of proxy preparation and solicitation?

The Company pays for the cost of proxy preparation and solicitation, including the charges and expenses of brokerage firms or other nominees for forwarding proxy materials to beneficial owners.

We are soliciting proxies by mail. In addition, proxies may be solicited personally by some of our directors, officers and regular employees. These individuals receive no additional compensation beyond their regular salaries for these services.

MATTERS TO BE CONSIDERED AT THE ANNUAL MEETING

ITEM 1: ELECTION OF DIRECTORS

Our stockholders are being asked to elect eight directors for the ensuing year or until the election and qualification of their respective successors. Directors are elected at each annual meeting of stockholders and hold office until their successors are duly elected and qualified at the next annual meeting of stockholders. Our Amended and Restated By-Laws ("By-Laws") provide that our Board will consist of not less than one, and not more than eight, members, with the exact number of directors determined by our Board. Our Board has set the number of directors at eight.

Under our By-Laws, each of our directors holds office for one-year terms or until his successor has been elected and qualified or until his earlier death, resignation, disqualification or removal. Directors need not be stockholders.

The Board believes the combined business and professional experience of the Company's directors make them a useful resource to management and qualify them for service as a director. Many of the Company's directors have served on the Board for a significant period of time. During their tenures, these directors have gained considerable knowledge about the Company and its operations. Continuity of service and the development of knowledge help make the Board more efficient and effective at developing long-range plans. The Board seeks directors who it believes can make significant contributions to the Board and the Company, based upon, among others, business and financial experience, business contacts, relationship skills, knowledge of the Company and its competitors, and diversity in experiences, perspectives and skills that are most appropriate to meet the Company's needs.

Nominees for Election

Capital Southwest Venture Corporation ("CSVC") has the right to designate two nominees for director to be included in management's slate of director nominees, so long as it owns at least 15% of the outstanding shares of our common stock, and one such nominee so long as it owns at least 10%, but less than 15%. CSVC has designated Messrs. Martin and Neblett, both of whom are currently directors, as its designees for nomination to our Board.

Each of the eight individuals listed has consented to being named as a nominee in this Proxy Statement and has indicated a willingness to serve if elected. However, if any nominee becomes unable to serve before the election, the shares represented by proxies may be voted for a substitute designated by the Board, unless a contrary instruction is indicated on the proxy.

The following persons have been nominated by our Board to be elected to serve on the Board at the 2012 Annual Meeting of Stockholders. All of the nominees are current directors. The following information is as of April 12, 2012.

Jerry R. Edwards
Age 65

Mr. Edwards has served as one of our directors since March 12, 2008. Mr. Edwards has been President, CEO and Chairman of the board of directors of Great Circle Ventures Holdings, LLC ("GCVH") since 2008, which is a private investment company formed by Mr. Edwards to acquire and operate Tail Activewear, Inc., which is a women's golf and tennis apparel company that distributes through pro shops and specialty retailers. Since 2005, Mr. Edwards has been Managing Director of Great Circle Ventures, LLC, a private investment firm founded in 2006 and a leading investor in GCVH. From 1998 until 2006, Mr. Edwards served as the Chief Executive Officer, President and acting Chairman of the board of directors of DASHAMERICA, Inc., doing business as Pearl Izumi USA, a brand of hi-tech, performance apparel and footwear for cycling, running, fitness and other active outdoor sports. In July 2005, Pearl Izumi USA was sold to Nautilus, Inc. (NYSE: NLS) at which time Mr. Edwards was appointed Vice President of Nautilus and President of the Nautilus Apparel and Footwear Division. From 1996 until 1998, Mr. Edwards served as Chief Operating Officer and President of Rodeer Systems, Inc., a transcription services business. Prior to that Mr. Edwards served as an executive of Lee Apparel Company, a division of VF Corporation, and Sales Technologies, Inc., a provider of field sales automation software and services, and in various capacities at Blue Bell, Inc., an apparel company. Mr. Edwards is a director and member of the compensation committee of ChartLogic, Inc. Mr. Edwards received a Bachelor of Science from East Carolina University, completed the USAF Meteorology Officer Program at Texas A&M University and received a Master of Science in systems management from the University of Southern California.

Mr. Edwards has over 25 years of experience managing high performing apparel and information technology operations. His extensive experience in the apparel industry, as well as his executive experience, is a valuable resource to our Board.

Patrick F. Hamner
Age 56

Mr. Hamner has served as one of our directors since May 2000 and was our Chairman of the Board until August 21, 2007. Mr. Hamner became a full-time employee of the Company in May 2006 and was one of our Senior Vice Presidents until May 1, 2008. Mr. Hamner provided the Company consulting services from April 2008 through June 2010. From January 2009 to December 2011, Mr. Hamner served as a Managing Director of Valesco Industries, which manages Valesco Commerce Street Capital, L.P., a $69MM Small Business Investment Company (SBIC) based in Dallas, Texas. Prior to May 2006, Mr. Hamner was a Senior Vice President of Capital Southwest Corporation, a Business Development Company (Nasdaq: CSWC), and its SBIC subsidiary Capital Southwest Venture Corporation, a firm with which he served for 24 years. From July 1998 to July 2007, Mr. Hamner served on the board of directors of Blue Magic, Inc., Jet-Lube, Inc., The RectorSeal Corporation and The Whitmore Manufacturing Company, all of which are chemical or lubricant manufacturing companies and are wholly owned by Capital Southwest Corporation. From 2001 to 2002, Mr. Hamner served as Chairman of the National Association of Small Business Investment Companies. Mr. Hamner currently serves on the board of directors of Marketplace Ministries Foundation. Mr. Hamner received a Bachelor of Science in mechanical engineering, cum laude, from Southern Methodist University and a Master of Business Administration and the Dean's Award from The University of Texas at Austin.

Mr. Hamner served as our founding Chairman of the Board and was instrumental in financing the startup of our business, recruiting management and setting strategic direction. As Chairman, Mr. Hamner was also involved with acquisition activities, financing our growth and developing our corporate governance. Mr. Hamner has over 30 years of private equity, business start-up and development experience. Mr. Hamner's service as one of our directors since 2000 and his service as our Senior Vice President provide our Board with an in-depth source of knowledge regarding our historical strategies, operations, management team and governance issues.

Mr. McGeachy's extensive functional and industry experience in the retail industry, sporting goods and equipment, new product development and innovation, marketing and brand building provides our Board with insight into important issues the Company faces.

Glenn M. Neblett
Age 40

Mr. Neblett joined our Board on August 25, 2010. Mr. Neblett is a Vice President at Capital Southwest Corporation, a business development company (Nasdaq: CSWC). Immediately prior to joining Capital Southwest Corporation in May 2010, Mr. Neblett was an investment banker with Houlihan Lokey for 10 years, advising clients in connection with mergers and acquisitions, leveraged buyouts, restructurings and capital-raising activities. He holds undergraduate (Bachelor of Business, accounting) and graduate (Master of Business Administration, finance) degrees from Baylor University and is a Chartered Financial Analyst and Certified Public Accountant. Mr. Neblett serves on the board of directors of the Capital Southwest Corporation portfolio companies KBI Biopharma Inc. and Trax Holdings, Inc. Capital Southwest Venture Corporation, which is a wholly owned subsidiary of Capital Southwest Corporation, beneficially owns more than 5% of our outstanding common stock.

Mr. Neblett has over 10 years of experience in the investment banking industry and brings a unique perspective to strategic corporate finance opportunities and initiatives that may be considered by the Company.

Ralph T. Parks
Age 66

Mr. Parks has served as one of our directors since January 30, 2008 and served as our Interim Chief Executive Officer from February 1, 2008 until May 20, 2008. Mr. Parks has been involved in the footwear industry since 1965 in various capacities, including sales, management and consulting. Mr. Parks retired in 1999 after a 34-year career in the retail industry, including eight years as Chief Executive Officer of Footaction USA, an athletic footwear and apparel retailer and was inducted into the Sporting Goods Industry Hall of Fame in May 2000. Since 2002, he has served as President of RT Parks, Inc., a retailer of New Balance® footwear and apparel. Since 2002, Mr. Parks has also served on the board of directors of Hibbett Sports, Inc. (NASDAQ: HIBB), an operator of sporting goods stores. Mr. Parks is on the audit committee and serves as chairman of the compensation committee of the board of directors of Hibbett Sports, Inc. Mr. Parks has served on the board of directors of Kirklands, Inc. (NASDAQ: KIRK), a retailer of home décor items, since 2005 and currently serves on the audit committee and is the chairman of the governance committee. Mr. Parks attended Southern State College in Arkansas (now Southern Arkansas University).

Mr. Parks' more than 34 years of experience in the retail industry, his service as our Interim Chief Executive Officer, as well as his service as Chief Executive Officer of Footaction USA, provides our Board with in-depth insight into the retail and footwear industry.

Richard F. Strup
Age 59

Mr. Strup was elected to our Board December 9, 2010. Mr. Strup is a retired consumer package goods executive with over 35 years of senior level domestic and international experience in marketing, finance, strategic planning and general management. Mr. Strup was the Senior Vice President of Corporate Strategy for Reyes Holdings, L.L.C., a leading food and beverage wholesale distributor serving customers throughout the U.S., Canada, and Latin America, from 2003 until his retirement in June 2011. Prior to Reyes Holdings, Mr. Strup was an executive at the Miller Brewing Company for 14 years where he spearheaded the commercial agreement with and integration into South African Breweries, managed the company's international business, and served as the Global Chief Marketing Officer. Prior to Miller Brewing Company, he held various marketing and financial positions in both the domestic and international divisions of Frito Lay, PepsiCo and General Foods Corp. His marketing expertise was acknowledged with "Advertising Campaign of the Year" honors in

1993 for Miller Genuine Draft in the U.S. and again in 1996 for Miller Pilsner in the U.K. Mr. Strup also has extensive knowledge in sports marketing being recognized six times in the Sporting News magazine's "Top 100 Most Powerful People" in sports. Mr. Strup currently serves on the board of directors of Atlantica, Inc. (OTC: ATTC), The Big Shoulders Fund (a non-profit organization whose mission is to provide support to Catholic schools in the neediest areas of inner-city Chicago), the Art of Olympians Foundation in Ft. Myers, Florida and the Maryland Baseball Holding Company (owner of several minor league teams). Previously he served on the board of directors of The Radiate Group, a division of Omincom Group, Inc. (NYSE: OMC) from 2005 through 2010. He is a long-standing member of Northwestern University's Kellogg School of Management Alumni Board and is a recipient of the school's "Pete Henderson Society" award for meritorious service. Mr. Strup earned a Bachelor of Arts degree in economics from Denison University, and a Master of Business Administration in marketing and finance from Northwestern University.

Mr. Strup's extensive background in consumer marketing/advertising, corporate strategic planning and international business development, as well as his executive experience, is a valuable resource to the Company.

The Board recommends that you vote "FOR" the election of each nominee named above.

ITEM 2: RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee is directly responsible for the appointment, termination, compensation and replacement of Heelys' independent registered public accounting firm. The Audit Committee has appointed Grant Thornton LLP ("Grant Thornton") as Heelys' independent registered public accounting firm. Grant Thornton has acted as Heelys' independent registered public accounting firm since June 30, 2009.

We are not required to submit this appointment to the stockholders for ratification, but the Board believes it is desirable as a matter of good corporate governance practice. If our stockholders fail to ratify the appointment, the Audit Committee may, but is not required to, reconsider whether to retain Grant Thornton. Even if the appointment is ratified, the Audit Committee in its discretion may direct the appointment of a different independent registered public accounting firm at any time during the fiscal year if it determines that such a change is in the best interests of the Company and its stockholders.

The Company expects that representatives of Grant Thornton will be present at the Annual Meeting, will have an opportunity to make a statement if they wish and will be available to respond to appropriate questions.

The Board recommends that you vote "FOR" the ratification of the appointment of Grant Thornton LLP as Heelys' independent registered public accounting firm.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information known to the Company with respect to beneficial ownership of our common stock as of April 12, 2012 by (i) each stockholder that the Company knows is the beneficial owner of more than 5% of our common stock, (ii) each director and nominee for director, (iii) each of the executive officers named in the Summary Compensation Table (the "Named Executive Officers"), (iv) each of our other officers and (v) all executive officers, other officers and directors as a group. The Company has relied upon information provided to the Company by its directors, Named Executive Officers and other officers and copies of documents sent to the Company that have been filed with the Securities and Exchange Commission by others for purposes of determining the number of shares each person beneficially owns.

Beneficial ownership is determined in accordance with the rules and regulations of the Securities and Exchange Commission and generally includes those persons who have voting or investment power with respect to the securities. Except as otherwise indicated, the persons named in the table have sole voting and investment power with respect to all shares of the Company's common stock beneficially owned by them. Shares of the

Company's common stock subject to options that are exercisable within 60 days of April 12, 2012 are also deemed outstanding for purposes of calculating the percentage ownership of that person, and if applicable, the percentage ownership of Named Executive Officers, other officers and directors as a group, but are not treated as outstanding for the purpose of calculating the percentage ownership of any other person. Unless otherwise indicated, the address for each stockholder listed in the table below is c/o Heelys, Inc., 3200 Belmeade Drive, Ste 100, Carrollton, Texas 75006.

Name of Beneficial Owner	Shares Beneficially Owned	Percentage
5% Holders Not Listed Below:		
Capital Southwest Venture Corporation(4)(6)	9,317,310	33.79%
Manatuck Hill Partners, LLC(13)	1,486,950	5.39%
Hodges Capital Management(14)	1,378,400	5.00%
Directors and named Executive Officers:		
Jerry R. Edwards(1)	20,000	*
Patrick F. Hamner(2)	1,153,150	4.07%
Thomas C. Hansen(3)	233,500	*
Gary L. Martin(4)	9,322,310	33.81%
N. Roderick McGeachy, III(5)	11,000	*
Glenn M. Neblett(6)	9,317,310	33.79%
Ralph T. Parks(7)	20,000	*
Richard F. Strup(8)	20,000	*
Craig D. Storey(9)	33,350	*
Richard C. Groesch, III(10)	13,000	*
John W. O'Neil(11)	46,250	*
All directors, Named Executive Officers and other officers as a group(11 persons)(12):	10,872,560	37.93%

* Less than 1 percent.

(1) Includes options to purchase an aggregate of 20,000 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(2) Includes options to purchase an aggregate of 790,000 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(3) Includes options to purchase an aggregate of 175,000 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(4) Includes 9,317,310 shares of common stock owned by CSVC. Mr. Martin is President, Chief Executive Officer and Chairman of the board of directors of Capital Southwest Corporation. CSVC, which is a wholly owned subsidiary of Capital Southwest Corporation, beneficially owns more than 5% of our outstanding common stock. Mr. Martin may be deemed to share voting power and investment power with respect to the shares of common stock beneficially owned by CSVC. Mr. Martin disclaims beneficial ownership of such shares. The address for Mr. Martin and CSVC is 12900 Preston Road, Suite 700, Dallas, Texas 75230.

(5) Includes options to purchase an aggregate of 10,000 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(6) Includes 9,317,310 shares of common stock owned by CSVC. Mr. Neblett is a Vice President at Capital Southwest Corporation. CSVC, which is a wholly owned subsidiary of Capital Southwest Corporation, beneficially owns more than 5% of our outstanding common stock. Mr. Neblett may be deemed to share voting power and investment power with respect to the shares of common stock

beneficially owned by CSVC. Mr. Neblett disclaims beneficial ownership of such shares. The address for Mr. Neblett and CSVC is 12900 Preston Road, Suite 700, Dallas, Texas 75230.

(7) Includes options to purchase an aggregate of 20,000 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(8) Includes options to purchase an aggregate of 5,000 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012. All of Mr. Strup's shares of common stock are owned by the Richard F. and Cindy D. Strup Revocable Trust UAD 11/12/96.

(9) Includes options to purchase an aggregate of 18,750 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(10) Includes options to purchase an aggregate of 10,000 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(11) Includes options to purchase an aggregate of 41,250 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(12) Includes options to purchase an aggregate of 1,090,000 shares of common stock that are currently exercisable or exercisable within 60 days of April 12, 2012.

(13) The mailing address for Manatuck Hill Partners, LLC is 1465 Post Road East, Westport, Connecticut, 06880. The beneficial ownership of Manatuck Hill Partners, LLC has been calculated as of December 31, 2011, which is the most recent date the Company obtained such information.

(14) The mailing address for Hodges Capital Management, Inc. is 2905 Maple Avenue, Dallas, Texas 75201. The beneficial ownership of Hodges Capital Management, Inc. has been calculated as of December 31, 2011, which is the most recent date the Company obtained such information.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and related regulations, require Heelys' directors, officers, and any persons holding more than 10 percent of Heelys' common stock (collectively, "Reporting Persons") to report their initial ownership of Heelys' securities and any subsequent changes in that ownership to the Securities and Exchange Commission. The Securities and Exchange Commission has established specific due dates for these reports, and Heelys is required to disclose in this Proxy Statement any failure of a Reporting Person to file a required report by the applicable due date.

Based solely on a review of copies of the reports filed and written representations submitted by the Reporting Persons, we believe that all Reporting Persons timely filed all required Section 16(a) reports for the most recent fiscal year.

EXECUTIVE OFFICERS

The following sets forth, as of April 12, 2012, our executive officers.

Thomas C. Hansen, age 55, has served as our Chief Executive Officer since August 1, 2009. His biography is contained in the section of this Proxy Statement entitled "Election of Directors."

Craig D. Storey, age 44, has served as our Chief Operating Officer and Chief Financial Officer since June 7, 2010. Prior to joining Heelys, Mr. Storey was the Chief Executive Officer and Chief Financial Officer of Sprig Toys, a preschool toy company which he cofounded and then later sold to Wham-O in February 2010. Prior to Sprig, Mr. Storey spent twelve years with Radica Games, a NASDAQ traded electronic toy and game

company headquartered in Hong Kong with offices in Dallas, Pasadena, Hertfordshire, UK and Dongguan, China. Mr. Storey began his career at Radica as the Assistant to the President in 1995, providing financial analysis and implementing process controls. In 1996, he was promoted to Controller of the US Division, where he served until he was promoted to Chief Accounting Officer for the parent company in Hong Kong in 1999. In 2002, Mr. Storey was promoted to Worldwide Chief Accounting Officer and Vice President of Finance and Operations, US Division, a position he retained until Radica was sold to Mattel in 2006. Mr. Storey remained with Mattel until he joined Sprig in 2007. Mr. Storey has a Bachelor of Science in finance from Arizona State University and is a certified public accountant in the State of Nevada. He also serves on the board of directors for Sprig Toys.

John W. O'Neil, age 66, has served as our Vice President, International since July 2007. Mr. O'Neil joined us from Dunham Bootmakers, a division of New Balance AS Inc., where he served as International Business Manager since 2005. In that role, Mr. O'Neil established business operations in Eastern Europe, Israel, Japan and Australia/New Zealand. From 1999 to 2004, Mr. O'Neil held the position of Regional General Manager at New Balance where he managed 3 subsidiaries and 18 distributors throughout Europe, the Middle East and Africa. Mr. O'Neil also spent 14 years at Converse, Inc., now a division of Nike, Inc. and served in various senior capacities including Regional Director for the United Kingdom and emerging markets and Director, International Marketing & Operations. Mr. O'Neil received a Bachelor of Science degree in mechanical engineering from Tufts University and a Master of Business Administration from American International College.

Richard C. Groesch, III, age 38, served as our Vice President, Brand Engagement from February 2010 until February 2011 when he was named our Chief Commercial Officer. Mr. Groesch comes to Heelys after holding various marketing positions throughout his 16 year career helping blue chip corporations realize their business and marketing goals. Mr. Groesch spent the 3 years prior to joining Heelys consulting and working on sports, event and entertainment properties for Verizon and Samsung as Vice President of Global Consulting for Gaylord Sports Group. From 2004 until 2007, he served in the Samsung family of businesses as the Global Sports Marketing Director, residing in Seoul, South Korea. While at Samsung, he worked on licensing agreements, global sports properties such as the Olympics and negotiated key market global sponsorships such as the partnership with Chelsea Football Club out of the United Kingdom. Mr. Groesch started his career working with General Motors as a client within the IPG family of advertising and marketing agencies. Throughout his 10+ years working at General Motors with Buick, Oldsmobile and Chevrolet, Mr. Groesch rose from the Account Executive to Director level working primarily in the sports, event and entertainment side of the business. Mr. Groesch has a Bachelor of Science in journalism and advertising, from the University of Nevada.

CORPORATE GOVERNANCE

Board of Directors' Leadership, Structure and Risk Oversight

The business and affairs of Heelys is managed by or under the direction of our Board. The Board derives its power and governance guidelines from our By-Laws and our Governance Principles. The complete text of our By-Laws and our Governance Principles are posted on the Investor Relations page of our website at www.heelys.com under the heading "Governance" and the sub-heading "Committees & Charters." In providing this oversight, the Board adheres to general guidelines designed to ensure that the Board has access to relevant information, and is structured and operates in a manner allowing it to exercise independent business judgment. The Board performs a number of functions for Heelys and its stockholders, including:

- reviewing and approving Heelys' long-term strategic plans;
- monitoring and evaluating management's systems for internal control, financial reporting and public disclosure;
- establishing corporate governance standards;

- planning for the effective succession of the Chief Executive Officer and other senior management;
- monitoring management's performance to ensure that the Company operates in an ethical manner; and
- reviewing and approving annual operating budgets.

According to our By-Laws, the Chairman of the Board may not be the Chief Executive Officer. The Board believes that the separation of these positions strengthens the independence of our Board and its ability to carry out its roles and responsibilities on behalf of our stockholders. In addition, the separation of the offices allows the Chairman of the Board to focus on the leadership of the Board while allowing our Chief Executive Officer to focus his time and energy on managing our operations.

The Board is actively involved in the oversight of risks that could affect the Company. This oversight is conducted primarily through the Audit Committee of the Board but also through the other committees of the Board, as appropriate. Our Chief Executive Officer brings members of our management from various business or administrative areas into meetings of the Board from time to time to make presentations and to provide insight to the Board, including insight into areas of potential risk. The Board and its committees, including the Audit Committee, satisfy this responsibility through reports by each committee chair regarding the committee's considerations and actions, as well as through regular reports directly from officers responsible for oversight of particular risks within the Company.

Director Independence

The listing rules of the Nasdaq Stock Market require that our Board be comprised of a majority of independent directors. In addition to the definition of independent director set forth in the listing rules of the Nasdaq Stock Market, Section 1 of Article III of our By-Laws sets forth additional requirements for a director or nominee to be considered "independent." Our By-Laws are posted on the Investor Relations page on our website at www.heelys.com under the heading "Governance" and the sub-heading "Committees & Charters."

The Board has determined that Messrs. Edwards, Martin, McGeachy, Neblett, Parks and Strup are independent directors as set forth in the listing rules of the Nasdaq Stock Market. The Board also determined that each member of the Company's Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee is an independent director in accordance with the charters of those committees and applicable Securities and Exchange Commission rules and regulations.

On an annual basis, each director and executive officer provides information to the Company pursuant to a Director and Officer Questionnaire. The information provided includes the identification of any transactions with the Company in which the director or executive officer, or any member of his immediate family, has a direct or indirect material interest. The information provided indicated that none of the directors has any material relationship (other than being a director or stockholder of the Company or as otherwise described herein) with the Company (either directly or indirectly).

Mr. Martin is President, Chief Executive Officer and Chairman of the board of directors of Capital Southwest Corporation and Mr. Neblett is a Vice President at Capital Southwest Corporation. CSVC, which is a wholly owned subsidiary of Capital Southwest Corporation, beneficially owns more than 5% of our outstanding common stock and has the right to designate up to two nominees of management's slate of directors. The Board has determined that, in its opinion, Mr. Martin's and Mr. Neblett's relationship with Capital Southwest Corporation would not interfere with their exercise of independent judgment in carrying out their responsibilities as directors. Mr. Martin and Mr. Neblett were designated for nomination to our Board by CSVC.

Mr. Parks has served as one of our directors since January 30, 2008 and served as our Interim Chief Executive Officer from February 1, 2008 until May 20, 2008. The Board has determined that, in its opinion, Mr. Parks' service as the Company's Interim Chief Executive Officer would not interfere with his exercise of independent judgment in carrying out his responsibilities as a director.

Code of Business Conduct and Ethics

The Board has adopted a Code of Business Conduct and Ethics that applies to all directors, executive officers and employees. Each of our directors, executive officers and employees are expected to conduct the business and affairs of the Company with honesty and integrity and are expected to adhere to high standards of conduct. The Company's objective is that all persons who deal with us believe that we not only scrupulously follow the law, but also act ethically and honestly. The Code sets out general principles to guide our directors, executive officers and employees in determining proper business conduct and in making ethical decisions as they perform their duties.

The complete text of our Code of Business Conduct and Ethics is posted on the Investor Relations page of our website at www.heelys.com under the heading "Code of Business Conduct and Ethics."

Policy Regarding Board Attendance at Stockholder Meetings

All of our directors and senior management are encouraged to attend every Company annual meeting of stockholders so that our stockholders will have the opportunity to meet and question a representative group of our directors and senior executives. All of our then current directors attended our 2011 annual meeting of stockholders. We expect all of our current directors to attend the 2012 annual meeting.

Related Party Transaction Policy and Procedures

Pursuant to resolutions adopted by our Board on August 29, 2006, all transactions between the Company and its officers, directors, principal stockholders and their affiliates must be consummated on terms no less favorable to the Company than could be obtained by the Company from unrelated third parties and must be approved by a majority of the outside independent and disinterested directors.

Board Meetings

The Board held 7 meetings during 2011. Each director attended at least 75 percent of the aggregate of all meetings of the Board and its committees on which he served. Pursuant to our By-Laws, the Board is not required to hold meetings on any regular schedule. Regular meetings may be held without notice at such time and at such place as may from time to time be determined by the Board. Special meetings may be called by the Chairman of the Board, the President, or any two or more directors or by one director in the event that there is only a single director in office. Directors must be notified of meetings at least 72 hours before the meeting.

Communication with the Board

Stockholders of the Company may communicate with our Board or any director by writing to the Board in a communication sent to our Corporate Secretary at 3200 Belmeade Drive, Ste 100, Carrollton, Texas 75006. Our Corporate Secretary will conduct an initial review of any such communication and will forward the communication to the director or directors to whom it is addressed, except only for communications that are (1) advertisements or promotional communications, (2) solely related to complaints regarding ordinary-course-of-business product or customer service or satisfaction issues or (3) clearly unrelated to the Company's business, industry, management or Board or committee matters. The Corporate Secretary also will make all such communications available to each member of the Board at the Board's next regularly scheduled meeting.

Board Committees

Our Board has established an Audit Committee, a Compensation Committee and a Nominating and Corporate Governance Committee. Each of these committees has a written charter approved by the Board establishing the authority and responsibilities of such committee. Each committee's charter is posted on the Investor Relations page of our website at www.heelys.com under the heading "Governance" and the sub-heading "Committees & Charters."

Audit Committee

The Audit Committee, established in accordance with Section 3(a)(58)(A) of the Exchange Act, reviews and monitors (i) our corporate financial reporting and our internal and external audits, including our internal audit and control functions, the results and scope of our annual audit and other services provided by our independent registered public accounting firm and (ii) our compliance with legal matters that have a significant impact on our financial reports. The Audit Committee also consults with management and our independent registered public accounting firm before the presentation of financial statements to stockholders and, as appropriate, initiates inquiries into aspects of our financial affairs. In addition, the Audit Committee has the responsibility to consider and appoint, and determine the services of and the fee arrangements with, our independent registered public accounting firm.

The Audit Committee has the power to establish subcommittees and delegate powers to such subcommittees. The Audit Committee has not established any such subcommittee or delegated any of its powers and has no current plans to do so.

The current members of the Audit Committee are Messrs. Strup, Edwards and McGeachy, each of whom has been determined to be independent by our Board. Our Board has determined that Mr. Strup, the current chairman of our Audit Committee, is an "audit committee financial expert" under applicable Securities and Exchange Commission rules and has the required financial sophistication pursuant to the listing rules of the Nasdaq Stock Market. The Audit Committee met 5 times during 2011.

Compensation Committee

The Compensation Committee determines, or reviews and approves, forms of compensation provided to our executive officers and our directors, including stock compensation. In addition, the Compensation Committee administers, and oversees the administration of the stock and other incentive compensation plans or programs for all of our other employees. As part of these responsibilities, the Compensation Committee administers the Heelys, Inc. 2006 Stock Incentive Plan, as amended and restated as of May 20, 2010 (the "2006 Plan"). Under the Compensation Committee's charter, the Compensation Committee may delegate the day-to-day administration of the compensation plan and programs to employees of the Company.

In addition, the Compensation Committee may establish subcommittees consisting of one or more members of the Compensation Committee, and delegate its authority and responsibilities to such subcommittees as it deems appropriate. The Compensation Committee has not established any subcommittees and currently has no plans to do so.

The current members of the Compensation Committee are Messrs. McGeachy, Martin, Neblett and Strup, each of whom has been determined to be independent by our Board. Mr. McGeachy is the current chairman of our Compensation Committee. The Compensation Committee met 5 times during 2011.

Nominating and Corporate Governance Committee

Established June 9, 2011, the Nominating and Corporate Governance Committee is responsible for reviewing the composition of the Board, as a whole, and recommending, if necessary, measures to be taken so that the Board reflects the appropriate balance of knowledge, experience, skill, expertise and diversity. In

addition, the Nominating and Corporate Governance Committee is responsible for identifying individuals qualified to become members of the Board and recommending that the Board select director nominees from among such qualified individuals. The Nominating and Corporate Governance Committee is also responsible for overseeing, reviewing and making periodic recommendations to the Board concerning corporate governance policies.

The Nominating and Corporate Governance Committee unanimously recommended to the Board that each of Jerry R. Edwards, Patrick F. Hamner, Thomas C. Hansen, Gary L. Martin, N. Roderick McGeachy, III, Glenn M. Neblett, Ralph T. Parks and Richard F. Strup be nominated for re-election as directors at this year's annual meeting of stockholders. The Board has nominated each of these individuals to the Board. For a discussion of the specific experience and qualifications of each of these individuals, see "Item 1. Election of Directors."

The current members of the Nominating and Corporate Governance Committee are Messrs. Parks, McGeachy and Martin. Mr. Parks is the current chairman of our Nominating and Corporate Governance Committee. The Nominating and Corporate Governance Committee met 2 times during 2011.

Director Nomination Process

The Nominating and Corporate Governance Committee reviews and interviews candidates who are qualified to satisfy the requirements for directors set forth in our By-Laws, makes recommendations to the Board for nominations and selects the management nominees for the directors to be elected by the Company's stockholders. The Nominating and Corporate Governance Committee may take into account all factors they consider appropriate in fulfilling their responsibilities to identify and recommend individuals to the Board as director nominees. Those factors may include, but are not necessarily limited to:

- an individual's business or professional experience, accomplishments, education, judgment, understanding of the business and the industry in which the Company operates, specific skills and talents, independence, time commitments, reputation, general business acumen and personal and professional integrity or character;

- the size and composition of the Board and the interaction of its members, in each case with respect to the needs of the Company and its stockholders;

- regarding any individual who has served as a director of the Company, his or her past preparation for, attendance at and participation in meetings and other activities of the Board or its committees and his or her overall contributions to the Board and the Company; and

- the length of such individual's service on the Board (it being the policy of the Company not to permit an individual to serve more than 15 years on the Board).

The Nominating and Corporate Governance Committee may use multiple sources for identifying and evaluating nominees for directors, including referrals from the Company's directors and management and input from third parties, such as executive-search firms retained by the Board. The Nominating and Corporate Governance Committee is required to interview candidates and obtain background information. The Company's other directors are given the opportunity to meet and interview candidates.

When considering director candidates the skills and characteristics of the candidate are considered in context of the current make-up of the Board, including, among other factors, diversity. This consideration may include diversity in experiences, perspectives and skills that are most appropriate to meet the Company's needs.

Nominees for directors who are recommended by any of the Company's stockholders are evaluated in the same manner as any other nominee for director. Stockholders may submit recommendations to the Nominating and Corporate Governance Committee, through a written notice addressed to the Company's

Secretary at the Company's principal executive offices, not less than 120 days nor more than 150 days before the anniversary of the date on which the Company's proxy statement was released to its stockholders in connection with the previous year's annual meeting of stockholders, or as otherwise provided in the Company's By-Laws.

A stockholder's written recommendation of a nominee must include or be accompanied by (1) all information relating to the recommended person that is required to be disclosed in solicitations of proxies for election of directors under the proxy rules of the Securities and Exchange Commission and such other information as the Company requires regarding the selection of directors, (2) all information regarding the proposed nominee, if required pursuant to our By-Laws, (3) a description of all compensation, agreements and relationships during the last three years between or among the proposing person, on the one hand, and the proposed nominee, his respective affiliates and associates and any other persons with whom the proposed nominee is acting in concert, on the other hand, including all information required to be disclosed pursuant to Item 404 of Regulation S-K if the proposing person were a "registrant" and the proposed nominee were a director or executive officer of such registrant, (4) a completed and signed questionnaire, representation and agreement (in form provided by our Corporate Secretary) that such proposed nominee (i) is not and will not become a party to (A) any agreement, arrangement or understanding with, and has not given any commitment or assurance to, any person or entity as to how such proposed nominee, if elected as a director of the Company, will act or vote on any issue or question (a "Voting Commitment") that has not been disclosed to the Company or (B) any Voting Commitment that could limit or interfere with such proposed nominee's ability to comply, if elected as a director of the Company, with such proposed nominee's fiduciary duties under applicable law, (ii) is not, and will not become a party to, any agreement, arrangement or understanding with any person or entity other than the Company with respect to any direct or indirect compensation, reimbursement or indemnification in connection with service or action as a director that has not been disclosed to the Company, (iii) such proposed nominee meets all of the qualifications for an independent director set forth in paragraphs (b) and (c) of Section 1 of Article III of our By-Laws, and (iii) in such proposed nominee's individual capacity and on behalf of the stockholder (or the beneficial owner, if different) on whose behalf the nomination is made, would be in compliance, if elected as a director of the Company, and will comply, with applicable publicly disclosed corporate governance, conflict of interest, confidentiality and stock ownership and trading policies and guidelines of the Company, and (5) a written statement from the recommended person that he or she is willing to be named in the proxy statement as a nominee and to serve as a director if elected.

In addition, such written recommendation must set forth as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination is made and any affiliate or associate of such stockholder or beneficial owners and any other person with whom such stockholder or beneficial owner is acting in concert (the "Proposing Person"), (1) the name and address of such Proposing Person, including, as applicable, as they appear on the Company's books; (2) the class and number of shares of the Company that are directly or indirectly owned of record or beneficially owned by such Proposing Person; (3) a representation that the stockholder is a holder of record of stock of the Company entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to propose such business or nomination; (4) as to each Proposing Person, (A) any derivative, swap or other transaction or series of transactions engaged in, directly or indirectly, by such Proposing Person, the purpose or effect of which is to give such Proposing Person economic risk similar to ownership of shares of any class or series of the Company, or which provide, directly or indirectly, the opportunity to profit from any increase in the price or value of shares of any class or series of the Corporation ("Synthetic Equity Interests"), which Synthetic Equity Interests shall be disclosed without regard to whether (x) the derivative, swap or other transactions convey any voting rights in such shares to such Proposing Person, (y) the derivative, swap or other transactions are required to be, or are capable of being, settled through delivery of such shares or (z) such Proposing Person may have entered into other transactions that hedge or mitigate the economic effect of such derivative, swap or other transactions, (B) any proxy (other than a revocable proxy or consent given in response to a solicitation made pursuant to, and in accordance with, Section 14(a) of the Exchange Act by way of a solicitation statement filed on Schedule 14A), agreement, arrangement, understanding or relationship pursuant to which such Proposing Person has or shares a right to vote any shares of any class or series of the Company, (C) any agreement, arrangement, understanding or relationship, including any repurchase or similar so-called "stock borrowing" agreement or arrangement, engaged in, directly or

indirectly, by such Proposing Person, the purpose or effect of which is to mitigate loss to, reduce the economic risk (of ownership or otherwise) of shares of any class or series of the Company by, manage the risk of share price changes for, or increase or decrease the voting power of such Proposing Person with respect to the shares of any class or series of the Company, or which provides, directly or indirectly, the opportunity to profit from any decrease in the price or value of the shares of an class or series of the Company ("Short Interests"), (D) any rights to dividends on the shares of any class or series of the Company owned beneficially by such Proposing Person that are separated or separable from the underlying shares of the Company, (E) any performance related fees (other than an asset based fee) that such Proposing Person is entitled to based on any increase or decrease in the price or value of shares of any class or series of the Company, or any Synthetic Equity Interests or Short Interests, if any, and (F) any other information relating to such Proposing Person that would be required to be disclosed in a proxy statement or other filing required to be made in connection with solicitations of proxies or consents by such Proposing Person in support of the business proposed to be brought before the meeting pursuant to Section 14(a) of the Exchange Act (the disclosures to be made pursuant to the foregoing clauses (A) through (F) are referred to as "Disclosable Interests"); provided, however, that Disclosable Interests shall not include any such disclosures with respect to the ordinary course business activities of any broker, dealer, commercial bank, trust company or other nominee who is a Proposing Person solely as a result of being the stockholder directed to prepare and submit the notice required by our By-Laws on behalf of a beneficial owner; and (5) a representation whether the Proposing Person intends or is part of a group which intends (x) to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the Company's outstanding shares of capital stock required to approve or adopt the proposal or elect the nominee; and/or (y) otherwise to solicit proxies from stockholders in support of such proposal or nomination.

Furthermore, if the stockholder (or a qualified representative of the stockholder) does not appear at the meeting of stockholders of the Company to present a nomination, such nomination shall be disregarded, notwithstanding that proxies in respect of such vote may have been received by the Company.

The Nominating and Corporate Governance Committee must also consider each individual designated in accordance with the Company's agreement with CSVC and certain of the Company's other stockholders pursuant to which CSVC has the contractual right to designate (i) two persons to be included in management's slate of director nominees so long as it owns at least 15% of the outstanding shares of Heelys' common stock, and (ii) one such nominee so long as it owns at least 10%, but less than 15%, of the outstanding shares of Heelys' common stock. CSVC has designated Messrs. Martin and Neblett to be nominated as directors of the Company at our 2012 Annual Meeting of Stockholders.

Limitation of Liability and Indemnification

Our Certificate of Incorporation includes a provision that eliminates the personal liability of our directors for monetary damages for breach of fiduciary duty as a director, except for liability:

- for any breach of the director's duty of loyalty to us or our stockholders;
- for acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of law;
- under Section 174 of the Delaware General Corporation Law regarding unlawful dividends and stock purchases; or
- for any transaction from which the director or officer derived an improper personal benefit.

Our By-Laws provide that:

- we must indemnify our directors and officers to the fullest extent permitted by Delaware law, subject to very limited exceptions;

- we may indemnify our other employees and agents to the same extent that we indemnify our directors and officers; and

- we must advance expenses, as incurred, to our directors and officers in connection with a legal proceeding to the fullest extent permitted by Delaware law, subject to very limited exceptions.

We have also entered into an indemnification agreement with each of our directors and officers containing provisions that require us to indemnify our directors and officers against liabilities that may arise by reason of their status or service as directors or officers, other than liabilities arising from willful misconduct of a culpable nature, to advance their expenses incurred as a result of any proceeding against them as to which they could be indemnified and to obtain directors' and officers' insurance if available on reasonable terms.

DIRECTOR COMPENSATION

In accordance with our By-Laws, our directors are entitled to compensation for their services as determined by our Compensation Committee. In addition, our directors may be entitled to the issuance of equity-based compensation awards under our 2006 Plan, from time to time, as determined by our Compensation Committee. Members of special or standing committees of the Board may be provided compensation for service as committee members, as determined by the Compensation Committee.

Currently, directors who receive compensation are paid $18,000 per year for serving on our Board, $5,000 per year, if applicable, for chairing a committee of our Board and, subject to an $8,000 per year maximum, $750 and $500 for each Board meeting and committee meeting, respectively, attended.

Currently, only Messrs. Edwards, McGeachy, Parks and Strup receive compensation for duties performed as directors. Messrs. Hamner, Martin and Neblett are not compensated. Directors who are also our officers or employees do not receive compensation for duties performed as directors. All directors are entitled to reimbursement of reasonable out-of-pocket expenses incurred in connection with their attendance at Board and committee meetings.

The following table summarizes compensation earned by our directors during 2011.

DIRECTOR COMPENSATION TABLE

	Fees Earned or Paid in Cash		
Name	Director Fees	Meeting Attendance	Total
Jerry R. Edwards(1)	$ 20,083	$ 6,750	$ 26,833
Patrick F. Hamner(2)	-	-	-
Thomas C. Hansen(3)	-	-	-
Gary L. Martin(2)	-	-	-
N. Roderick McGeachy, III(4)	23,000	8,000	31,000
Glenn M. Neblett(2)	-	-	-
Ralph T. Parks(5)	20,917	6,250	27,167
Richard F. Strup(6)	20,917	7,250	28,167
	$ 84,917	$ 28,250	$ 113,167

(1) Mr. Edwards was the Chairman of the Audit Committee until June 9, 2011.

(2) Messrs. Hamner, Martin and Neblett do not receive compensation for duties performed as a director.

(3) Because Mr. Hansen is a Company officer and employee he is not compensated for duties performed as a director.

(4) Mr. McGeachy is Chairman of the Compensation Committee.

(5) Mr. Parks is Chairman of the Nominating and Corporate Governance Committee, which was established June 9, 2011.

(6) Mr. Strup was appointed the Chairman of the Audit Committee June 9, 2011.

The following table sets forth the number of shares underlying stock options held by each non-employee director as of December 31, 2011. No stock options have been granted to either Mr. Martin or Mr. Neblett. Refer to the section "Executive Compensation" in this Proxy Statement for discussion regarding stock options and other equity awards granted to Mr. Hansen.

OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2011

Name	Date of Grant	Number of Shares Granted(2)	Exercise Price	Number of Shares Vested	Number of Shares Unvested	Number of Shares Outstanding
Jerry R. Edwards	5/30/2008	20,000	$ 4.39	15,000	5,000	20,000
Patrick F. Hamner(1)	6/23/2006	790,000	$ 4.05	790,000	-	790,000
N. Roderick McGeachy, III	11/17/2009	20,000	$ 2.15	10,000	10,000	20,000
Ralph T. Parks	3/6/2008	20,000	$ 4.26	15,000	5,000	20,000
Richard F. Strup	12/9/2010	20,000	$ 3.37	5,000	15,000	20,000

(1) Stock options were granted to Mr. Hamner when Mr. Hamner was an officer of the Company. Mr. Hamner resigned his position with the Company effective as of April 30, 2008. Options continued to vest in accordance with the 2006 Plan so long as Mr. Hamner remained a member of the Board. As of June 30, 2010, all options granted to Mr. Hamner had fully vested. Contractual term of the grant is ten years.

(2) All stock options granted, with the exception of stock options granted to Mr. Hamner, vest and become exercisable in four equal installments on each successive anniversary date of the grant and have a contractual term of ten years.

EXECUTIVE COMPENSATION

Introduction

The following discussion should be read in conjunction with the various tables and accompanying narrative disclosures appearing in this Proxy Statement. Those tables and narrative provide more detailed information regarding the compensation and benefits awarded to, earned by, or paid to our Chief Executive Officer and the other executive officers named in the Summary Compensation Table.

The Compensation Committee determines, or reviews and approves, forms of compensation provided to Messrs. Hansen, Storey and O'Neil (our Named Executive Officers), including stock compensation, to ensure that total compensation paid to those officers is fair, reasonable and competitive.

Philosophy

Our philosophy is to align our executives' compensation with the Company's business strategies in an effort to drive overall organizational success and stockholder value. The Compensation Committee works with the Company to design compensation programs that are designed to, among other things:

- attract and retain highly qualified executives;
- motivate our executives to accomplish the Company's objectives; and
- align our executives' interests with those of our stockholders in a manner that minimizes risk to the organization.

To achieve these goals, we use a combination of base salary, short-term performance-based bonuses and long-term incentive compensation that may be weighted to establish the correct mix of overall compensation.

The Compensation Committee evaluates our executives' compensation on an annual basis and makes changes accordingly. In addition to reviewing our executives' compensation in relation to comparable industry competitors and other companies in our market, the Compensation Committee also takes into account current economic conditions and financial projections.

We do not believe that our compensation policies and practices, as they relate to risk management and risk taking incentives, create risks that are reasonably likely to have a material adverse effect on the Company.

Base Salary

To attract and retain executive officers, we pay our executive officers a base salary at a level we believe is competitive with the companies with which we compete. The executive's base salary is the only non-contingent component of annual cash compensation. In setting these salaries, the Compensation Committee considers the scope of the executive's responsibilities, unique skill sets and experience, individual contributions and performance, ability to meet key objectives, market conditions, current compensation compared to peer and competitor companies, and the specific actions and strategic activities of each executive officer.

Mr. Hansen has served as our Chief Executive Officer since August 2009. During each of 2010 and 2011, Mr. Hansen's annual base salary was $430,000. Effective February 16, 2012, Mr. Hansen's annual base salary was increased to $440,000. The increase in Mr. Hansen's annual base salary was approved by the Compensation Committee.

Mr. Storey was appointed as our Chief Operating and Financial Officer effective June 7, 2010. During each of 2010 and 2011, Mr. Storey's annual base salary was $200,000 (prorated for 2010). Effective February 16, 2012, Mr. Storey's annual base salary was increased to $206,000. The increase in Mr. Storey's base salary was approved by the Compensation Committee.

Mr. O'Neil has served as our Vice President, International since July 2007. Effective as of March 1, 2010, Mr. O'Neil's base salary was increased from $145,000 to $175,000. The Compensation Committee approved the increase in Mr. O'Neil's base salary after a review of the scope of his responsibilities, unique skill sets and experience.

Performance-Based Bonuses

Bonuses are intended to reward behavior and results that assist in meeting the Company's business, strategic and financial goals. The opportunity to earn, and the amount of, a bonus is determined in accordance with criteria established by the Board or Compensation Committee and may include Company business objectives, Company earnings or other financial criteria applicable to the executive, the Company or both.

Discretionary bonuses may also be paid. Any discretionary bonuses paid to the Chief Executive Officer are made at the discretion of the Compensation Committee or the Board. Any discretionary bonuses made to the Chief Executive Officer's direct reports, which would include the Named Executive Officers, are

made at the discretion of the Compensation Committee or the Board, based upon recommendations by the Chief Executive Officer.

2010 Management Incentive Bonus Plans

Messrs. Hansen and Storey:

For fiscal 2010, the Board, on the recommendation of the Compensation Committee, adopted a management incentive bonus plan for our Named Executive Officers (other than John O'Neil) and senior management, which, in the judgment of the Compensation Committee and the Board, would facilitate our overall growth and performance and would compensate our management for performance results achieved.

No bonuses were earned under the 2010 management incentive bonus plan.

Mr. O'Neil:

We entered into an employment agreement with Mr. O'Neil, our Vice President, International, in October 2008, which was amended on February 18, 2010. The amendment increased Mr. O'Neil's base salary and raised the amount of the annual bonus amount to which Mr. O'Neil was eligible to 40% of his base salary. The actual bonus amount, if any, would vary depending on performance against the targets approved by the Compensation Committee. The payout opportunity was based 50% on total international gross sales and 50% on total international operating income. The increase in the amount of the annual bonus amount to which Mr. O'Neil was eligible was based upon recommendation of the Chief Executive Officer.

No bonus was earned by Mr. O'Neil for 2010.

2011 Management Incentive Bonus Plan

On February 17, 2011, the Board, upon recommendation of the Compensation Committee, approved the Company's 2011 management incentive bonus plan for our officers and senior management, including our Named Executive Officers. As with the 2010 management bonus incentive plan, in the judgment of the Compensation Committee and the Board, the 2011 management incentive bonus plan would facilitate our overall growth and performance and would compensate our management for performance results achieved. Under the 2011 management incentive bonus plan, target bonus opportunities are expressed as a percentage of base salary, with threshold, target and maximum payout opportunities expressed as a percentage of the target award. No cash bonuses would be paid if we did not achieve at least the threshold performance level. Mr. Hansen's annual incentive bonus was set at a target amount of 50% of base salary and the target bonus for our other executive officers, including our Named Executive Officers, was set at 30% of base salary.

Actual bonus amounts, if any, would vary depending on our performance against the targets established by the Board. If we achieved (1) the threshold level, a participant in the 2011 management incentive bonus plan would have been eligible for 50% of his/her target bonus; (2) the target level, a participant would have been eligible for 100% of his/her target bonus; and (3) the maximum level, a participant would have been eligible for 250% of his/her target bonus. Under the 2011 management incentive bonus plan, the bonus paid to a participant could have been varied up to 20% higher or lower based on a subjective assessment of the individual's performance and contribution to achieving the performance goals.

The Compensation Committee considered various performance measures for the 2011 management incentive bonus plan. For Messrs. Hansen and Storey, the payout opportunities under the 2011 management incentive bonus plan were based 25% on total Company net sales and 75% on total Company profit before taxes. For Mr. O'Neil, the payout opportunities under the 2011 management incentive bonus plan were based 25% on total Company net sales, a portion of which was based on international net sales, and 75% on total Company profit before taxes, a portion of which was based on international operating income. The performance levels adopted for the 2011 management incentive bonus plan were, in the judgment of the Compensation

Committee and the Board, set at levels that would facilitate our overall growth and performance. Under the 2011 management incentive bonus plan, the Board retained the discretion to exclude certain one-time, non-operating items that may occur in the performance period from the bonus calculation.

For the 2011 management incentive plan, the threshold performance level for total Company net sales was met and exceeded; however, the threshold performance level for the other performance measures, including international performance measures, were not met. As a result, Messrs. Hansen and Storey earned 15.06% of their target bonus amounts, and were paid $32,388 and $9,038, respectively. Mr. O'Neil earned 7.53% of his target bonus amount, and was paid $3,954.

The Compensation Committee worked with the Chief Executive Officer and Chief Financial Officer in determining the performance measures for the 2011 management incentive bonus plan.

2012 Management Incentive Bonus Plan

On March 16, 2012, the Board, upon recommendation of the Compensation Committee, approved the Company's 2012 management incentive bonus plan for our Named Executive Officers (other than John O'Neil) and senior management. As with the 2010 and 2011 management bonus incentive plans, in the judgment of the Compensation Committee and the Board, the 2012 management incentive bonus plan is expected to facilitate our overall growth and performance and compensate our management for performance results achieved. Under the 2012 management incentive bonus plan, target bonus opportunities are expressed as a percentage of base salary, with threshold, target and maximum payout opportunities expressed as a percentage of the target award. No cash bonuses will be paid if we do not achieve at least the threshold performance level for the 2012 fiscal year. Mr. Hansen's annual incentive bonus is set at a target amount of 50% of his 2012 base salary wages and Mr. Storey's annual incentive bonus is set at a target amount of 30% of his 2012 base salary wages.

Actual bonus amounts, if any, will vary depending on our performance against the targets established by the Board. If we achieve (1) the threshold level, a participant in the 2012 management incentive bonus plan will be eligible for 68.75% of his/her target bonus; (2) the target level, a participant would be eligible for 100% of his/her target bonus; and (3) the maximum level, a participant would be eligible for 200% of his/her target bonus. The Board retains the discretion to decrease the bonus paid to a participant by up to 20% based on a subjective assessment of the individual's performance and contribution to achieving the performance goals.

The Compensation Committee considered various performance measures for the 2012 management incentive bonus plan. For Messrs. Hansen and Storey, the payout opportunities under the 2012 management incentive bonus plan are based 25% on total Company net sales and 75% on total Company profit before taxes. The performance levels adopted for the 2012 management incentive bonus plan are, in the judgment of the Compensation Committee and the Board, set at levels that would facilitate our overall growth and performance. The Compensation Committee (as delegated by the Board) may, in its discretion, adjust the payout opportunities under the 2012 management incentive plan to reflect any extraordinary changes which may occur in 2012, such as changes in accounting practices, tax, regulatory or other laws or regulations, or economic changes not in the ordinary course of business cycles and any unusual or infrequently occurring items.

The Compensation Committee worked with the Chief Executive Officer and Chief Financial Officer in determining the performance measures for the 2012 management incentive bonus plan.

The amounts payable under the 2012 management incentive bonus plan are not determinable at present. However, if, during fiscal 2012, the Company's financial performance reaches the threshold level for both net sales and profit before tax, the maximum bonuses available to Messrs. Hansen and Storey, assuming their base salaries are not increased, will be $150,820 and $42,333, respectively. If the Company's financial performance reaches the target level in 2012 for both net sales and profit before tax, the maximum bonuses available to Messrs. Hansen and Storey, assuming their base salaries are not increased, will be $219,375 and $61,575, respectively. If the Company's financial performance reaches the maximum level in 2012 for both net

sales and profit before tax, the maximum bonuses available to Messrs. Hansen and Storey, assuming their base salaries are not increased, will be $438,750 and $123,150, respectively.

Because the 2012 management incentive bonus plan is intended to align the interests of the participant and the Company's stockholders, the Compensation Committee may, upon certain events specified in the 2012 management incentive bonus plan, in its discretion, disqualify the participant from earning or receiving payment, in whole or in part, of a bonus payout amount under the 2012 management incentive bonus plan. The Compensation Committee may require a participant to reimburse the Company in the event a bonus payout amount under the 2012 management incentive bonus plan is paid to a participant based on achievement of financial results that are subsequently the subject of restatement on account of the participant's intentional misconduct.

Long-Term Incentive Compensation

We view the long-term incentive component of our total compensation program as both a retention tool and a mechanism to incentivize our officers and senior management, including our Named Executive Officers. We currently use equity grants (restricted stock units) and performance based cash bonuses for our long-term incentive compensation.

2010 Long-Term Incentive Award

On August 25, 2010, the Board, upon recommendation of the Compensation Committee, approved an award (the "2010 LTI Award") of restricted stock units to Mr. Hansen. The 2010 LTI Award is designated as a performance award subject to the terms and conditions of the 2006 Plan, and the underlying award agreement.

To support the Company's focus on creating long-term stockholder value, the 2010 LTI Award is subject to performance criteria based on earnings per share of the Company ("EPS") during the period beginning May 1, 2010 and ending December 31, 2012 (the "2010 LTI Performance Period"). EPS will be determined by dividing the Company's consolidated net income or loss by the number of basic common shares of the Company for the period May 1, 2010 through December 31, 2010 and each of the twelve-month periods beginning January 1 and ending December 31 for 2011 and 2012 (each, a "2010 LTI Performance Year"). If at the end of the 2010 LTI Performance Period, Mr. Hansen's Continuous Service (as defined in the 2006 Plan) has not been terminated and at least the threshold EPS performance level has been achieved for at least one of the 2010 LTI Performance Years, a portion of the restricted stock units will be earned and, to the extent vested, common stock of the Company will be issued to Mr. Hansen. The number of restricted stock units awarded to Mr. Hansen was based on the closing price of the Company's common stock at the close of the Nasdaq Stock Market on August 25, 2010 (the grant date). The closing price of the Company's common stock on the grant date was $2.36.

The calculation of the number of restricted stock units that will vest at the end of the 2010 LTI Performance Period is based on an average of the EPS performance levels achieved during each of the 2010 LTI Performance Years. The underlying award agreement identifies three EPS performance levels, with the number of restricted stock units subject to vesting expressed as a percentage of the specified target award, as follows:

Threshold EPS Performance Level	Target EPS Performance Level	Maximum EPS Performance Level
(as a % of Target)	(as a % of Target)	(as a % of Target)
50%	100%	200%

The target award granted to Mr. Hansen was 95,339 of restricted stock units. If the threshold EPS performance level for each 2010 LTI Performance Years is not achieved, the number of restricted stock units subject to vesting will be zero. The maximum number of restricted stock units subject to vesting was 190,678. Because EPS threshold performance level for the period May 1, 2010 through December 31, 2010, and for the period January 1, 2011 through December 31, 2011, was not achieved 127,119 of the restricted stock units were deemed to have been forfeited. If threshold EPS performance level is met for the remaining 2010 LTI Performance Year, 15,890 of the restricted stock units will become subject to vesting. If maximum EPS performance level is met for the remaining 2010 LTI Performance Year, 63,559 of the restricted stock units will become subject to vesting.

The actual market value of restricted stock units, if any, awarded on the payment date (i.e., at the end of the 2010 LTI Performance Period and subject to any vesting requirements) may be higher or lower than the market value of the restricted stock units as of the grant date depending on the market value of the Company's common stock on such payment date relative to the market value on the grant date.

2011 Long-Term Incentive Awards

On February 17, 2011, the Board, upon recommendation of the Compensation Committee, approved awards (the "2011 LTI Award") of restricted stock units to our officers and senior management, including our Named Executive Officers. The 2011 LTI Awards are designated as performance awards subject to the terms and conditions of the 2006 Plan, and the underlying award agreements.

To support the Company's focus on creating long-term stockholder value, the 2011 LTI Awards are subject to performance criteria based on EPS during the period beginning January 1, 2011 and ending December 31, 2013 (the "2011 LTI Performance Period"). EPS will be determined by dividing the Company's consolidated net income or loss by the number of basic common shares of the Company for each of the twelve-month periods beginning January 1 and ending December 31 for 2011, 2012 and 2013 (each, a "2011 LTI Performance Year"). If at the end of the 2011 LTI Performance Period, the participant's Continuous Service (as defined in the 2006 Plan) has not been terminated and at least the threshold EPS performance level has been achieved for at least one of the 2011 LTI Performance Years, a portion of the restricted stock units will be earned and, to the extent vested, common stock of the Company will be issued to the participant. The number of restricted stock units awarded to a participant was based on the closing price of the Company's common stock at the close of the Nasdaq Stock Market on March 15, 2011 (the grant date). The fair market value of the Company's common stock at the close of the market on the grant date was $2.19.

The calculation of the number of restricted stock units that will vest at the end of the 2011 LTI Performance Period will be based on an average of the EPS performance levels achieved during each of the 2011 LTI Performance Years. The underlying award agreements identify three EPS performance levels, with the number of restricted stock units subject to vesting expressed as a percentage of a specified target award, as follows:

Threshold EPS Performance Level (as a % of Target)	Target EPS Performance Level (as a % of Target)	Maximum EPS Performance Level (as a % of Target)
50%	100%	200%

The target awards granted to Messrs. Hansen, Storey and O'Neil are 98,174, 38,813 and 34,247 of restricted stock units, respectively. If the threshold level EPS performance level for each of the 2011 LTI Performance Years was not achieved, the number of restricted stock units subject to vesting would have been zero. However, the threshold EPS performance level was achieved for the twelve-month period beginning January 1, 2011 and ending December 31, 2011, and therefore the minimum number of restricted stock units subject to vesting, assuming the threshold EPS performance level for the remaining 2011 LTI Performance Years is not achieved, will be 16,362 for Mr. Hansen, 6,469 for Mr. Storey and 5,708 for Mr. O'Neil. The actual number of restricted stock units that may vest pursuant to the 2011 LTI Award will range between

16,362, 6,469 and 5,708, and 147,261, 58,220 and 51,371 if the maximum EPS performance level is attained for the remaining 2011 LTI Performance Years, for Messrs. Hansen, Storey and O'Neil, respectively. For purposes of calculating EPS for 2011, the Board, upon recommendation of the Compensation Committee, approved the exclusion of the impact of inventory impairment charges and related reserve adjustments in the amount of $812,000, which was attributable to inventory purchased in the first quarter of 2011 from the Company's then Japanese distributor.

The actual market value of restricted stock units, if any, awarded on the payment date (i.e., at the end of the 2011 LTI Performance Period and subject to any vesting requirements) may be higher or lower than the market value of the restricted stock units as of the grant date depending on the market value of the Company's common stock on such payment date relative to the market value on the grant date.

2012 Long-Term Incentive Awards

On March 16, 2012, the Board, upon recommendation of the Compensation Committee, approved awards (the "2012 LTI Award") of restricted stock units to our Named Executive Officers (other than John O'Neil) and senior management. The 2012 LTI Awards are designated as performance awards subject to the terms and conditions of the 2006 Plan and the underlying award agreements.

To support the Company's focus on creating long-term stockholder value, the 2012 LTI Awards are subject to performance criteria based on EPS during the period beginning January 1, 2012 and ending December 31, 2014 (the "2012 LTI Performance Period"). EPS will be determined by dividing the Company's consolidated net income or loss by the number of basic common shares of the Company for each of the twelve-month periods beginning January 1 and ending December 31 for 2012, 2013 and 2014 (each, a "2012 LTI Performance Year"). If at the end of the 2012 LTI Performance Period, the participant's Continuous Service (as defined in the 2006 Plan) has not been terminated and at least the threshold EPS performance level has been achieved for at least one of the 2012 LTI Performance Years, a portion of the restricted stock units will be earned and, to the extent vested, common stock of the Company will be issued to the participant. The number of restricted stock units awarded to the participant was based on the closing price of the Company's common stock at the close of the Nasdaq Stock Market on March 26, 2012 (the grant date). The closing price of the Company's common stock on the grant date was $2.45.

The calculation of the number of restricted stock units that will vest at the end of the 2012 LTI Performance Period will be based on an average of the EPS performance levels achieved during each of the 2012 LTI Performance Years. The underlying award agreements identify three EPS performance levels, with the number of restricted stock units subject to vesting expressed as a percentage of a specified target award, as follows:

Threshold EPS Performance Level (as a % of Target)	Target EPS Performance Level (as a % of Target)	Maximum EPS Performance Level (as a % of Target)
50%	100%	200%

The target awards granted to Messrs. Hansen and Storey are 44,652 and 18,142 of restricted stock units, respectively. If the threshold EPS performance level for each of the 2012 LTI Performance Years is not achieved, the number of restricted stock units subject to vesting for each of Messrs. Hansen and Storey will be zero. The actual number of restricted stock units that may vest pursuant to the 2012 LTI Award for Mr. Hansen will range between 7,442 (representing the number of restricted stock units to be awarded if the threshold EPS performance level is achieved for at least one of the 2012 LTI Performance Years) and 89,304 restricted stock units (representing the number of restricted stock units to be awarded if the maximum EPS performance level is achieved for each of the 2012 LTI Performance Years). The actual number of such restricted stock units that may vest for Mr. Storey will range between 3,024 restricted stock units (representing the number of restricted stock units to be awarded if the threshold EPS performance level is achieved for at least one of the 2012 LTI

Performance Years) and 36,284 restricted stock units (representing the number of restricted stock units to be awarded if the maximum EPS performance level is achieved for each of the 2012 LTI Performance Years).

The actual market value of restricted stock units, if any, awarded on the payment date (i.e., at the end

disqualify the participant from earning or receiving payment, in whole or in part, of a bonus payout amount under the LTMIP. The Compensation Committee may require a participant to reimburse the Company in the event a bonus payout amount under the LTMIP is paid to a participant based on achievement of financial results that are subsequently the subject of restatement on account of the participant's intentional misconduct.

Equity Based Compensation Awards

Equity based incentive compensation is intended to align the interests of the Company's executives with the interests of the stockholders. We believe that it also allows the Company to attract able individuals and to provide a means whereby those individuals, upon whom the responsibilities of the successful administration and management of the Company are of importance, can acquire and maintain stock ownership, reinforcing their concern for the welfare of the Company. The Compensation Committee may, if deemed necessary and desirable, grant equity-based compensation awards to any officer or employee of the Company for such number of shares of common stock as the Compensation Committee may deem to be in the best interest of the Company. Equity grants are made at the discretion of the Compensation Committee.

Retirement Program

Our executive officers are eligible to participate in the same qualified retirement program available to the employees of Heeling Sports Limited (a Texas limited partnership and wholly-owned subsidiary of Heelys, Inc.). The program consists of a 401(k) plan.

Perquisites and Other Personal Benefits

Mr. O'Neil lives in Belgium to manage our international operations. Mr. O'Neil's annual base salary is subject to adjustment each calendar quarter during the term of his employment agreement to ensure that he has received during each calendar quarter a Euro net equivalent of US$8,808 per month (US$6,625 when Mr. O'Neil's base salary was $145,000) after certain deductions from Mr. O'Neil's salary, and the Company will reduce Mr. O'Neil's base salary by the amount of any housing allowance the Company pays or has paid on Mr. O'Neil's behalf.

In 2011 and 2010, Mr. O'Neil, pursuant to his employment agreement, was reimbursed for certain expenses related to domicile in a foreign country. These expenses included travel to the United States, automobile lease expenses, housing expenses and gross up of wages for payment of personal income taxes if necessary to pay additional income taxes on Mr. O'Neil's earnings (in excess of the taxes deducted from Mr. O'Neil's earnings).

As discussed further below in the section entitled "POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE-IN-CONTROL," Mr. O'Neil has been notified that his employment will be terminated, effective as of July 1, 2012, and he will receive certain benefits upon his termination pursuant to his employment agreement. Mr. O'Neil's employment is being terminated in connection with our previously disclosed international efficiency and cost reduction initiative and the closure of our office in Brussels, Belgium, which commenced in the first quarter of 2012.

Equity Award Grant Policy

In June 2006, the Company adopted the 2006 Plan, which the Company amended and restated on May 20, 2010. The purpose of the 2006 Plan is to provide certain key employees, non-employee directors and consultants with a proprietary interest in the Company through the granting of stock options and awards of restricted stock units.

Equity awards are granted at the discretion of the Compensation Committee.

As of April 12, 2012, there were 162,738 shares of our common stock remaining available that may be granted to employees, consultants and nonemployee directors of the Company under the 2006 Plan. Stockholder approval would be necessary to increase the number of shares available for equity-based compensation awards.

Compliance with Section 162(m) of the Internal Revenue Code

Section 162(m) of the Internal Revenue Code limits the deductibility of compensation in excess of $1 million paid to certain executive officers, unless such compensation qualifies as "performance-based compensation." Among other things, in order to be deemed performance-based compensation for Section 162(m) purposes, the compensation must be based on the achievement of pre-established, objective performance criteria and must be pursuant to a plan that has been approved by the Company's stockholders. The amount of compensation and the timing of the deductibility of compensation attributable to restricted stock unit and stock option awards depends upon the timing of an executive's vesting (in the case of restricted stock units) or exercise (in the case of stock options if the exercise results in reportable income to the executive), whether those awards qualify as "performance-based compensation," as well as interpretations and changes in the tax laws and other factors beyond the Compensation Committee's control. For these and other reasons, including the need to maintain flexibility in compensating executive officers in a manner designed to promote varying corporate goals, the Compensation Committee will not necessarily, or in all circumstances, limit executive compensation to that which is deductible under Section 162(m) and has not adopted a policy requiring that all compensation be deductible.

EXECUTIVE COMPENSATION TABLES

The following Summary Compensation Table sets forth information concerning the compensation paid to or earned by: (i) the Chief Executive Officer and (ii) the Company's other Named Executive Officers listed below. We refer to the individuals listed in the table below as the "Named Executive Officers" throughout this Proxy Statement. The compensation described in this table does not include medical, group life insurance or other benefits that are generally available to all of our salaried employees.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary	Bonus(4)	Restricted Stock Unit Awards(5)	Stock Option Awards(6)	All Other Compensation (7)	Total
Thomas C. Hansen(1) ...	2011	$ 430,000	$ 32,388	$ 215,000	$ -	$ 8,234	$ 685,622
Chief Executive Officer.	2010	$ 430,000	$ 5,000	$ 225,000	$ -	$ 8,706	$ 668,706
Craig D. Storey(2).....	2011	$ 200,000	$ 9,038	$ 85,000	$ -	$ 5,750	$ 299,788
Chief Operating/Financial Officer	2010	$ 113,714	$ 5,000	$ -	$ 88,902	$ 16,650	$ 224,266
John W. O'Neil(3)	2011	$ 175,000	$ 3,954	$ 75,000	$ -	$ 98,182	$ 352,136
Vice President, International	2010	$ 170,007	$ -	$ -	$ -	$ 84,525	$ 254,532

(1) During 2010 and 2011, Mr. Hansen's annual base salary was $430,000. Effective February 16, 2012, Mr. Hansen's annual base salary was increased to $440,000.

(2) Craig D. Storey was appointed Chief Operating and Financial Officer effective June 7, 2010. During 2010 and 2011, Mr. Storey's annual base salary was $200,000 (prorated for 2010). Effective February 16, 2012, Mr. Storey's annual base salary was increased to $206,000.

(3) Mr. O'Neil has served as our Vice President, International since July 2007. Effective as of March 1, 2010, Mr. O'Neil's base salary was increased from $145,000 to $175,000.

(4) Amounts consist of cash incentive compensation awards earned for services rendered during the year. Bonuses earned in 2011 were awarded in accordance with the 2011 management incentive bonus plan. Bonuses earned in 2010 were discretionary and approved by the Compensation Committee.

(5) Messrs. Hansen, Storey and O'Neil were awarded restricted stock units on February 17, 2011 (with a grant date of March 15, 2011). The awards are subject to performance criteria based on EPS of the Company during the period January 1, 2011 and ending December 31, 2013. The target awards granted to Messrs. Hansen, Storey and O'Neil were 98,174, 38,813 and 34,247 of restricted stock units, respectively. The maximum number of restricted stock units subject to vesting at the grant date was 196,348 for Mr. Hansen, 77,626 for Mr. Storey and 68,494 for Mr. O'Neil. Mr. Hansen was awarded restricted stock units on August 25, 2010 (with a grant date of August 25, 2010). The award is subject to performance criteria based on EPS of the Company during the period May 1, 2010 and ending December 31, 2012. The target award granted to Mr. Hansen was 95,339. The maximum number of restricted stock units subject to vesting at date of grant was 190,678. The Company determines the fair value of restricted stock unit awards based on the closing trade price of the Company's common stock on the grant date. The closing trade price of the Company's common stock was $2.19 on March 15, 2011 and $2.36 on August 25, 2010. The dollar amount in the Restricted Stock Unit Awards column reflects the aggregate grant date fair value of awards expected to vest if target EPS performance level was achieved.

(6) Dollar amounts in the Stock Option Awards column reflect the aggregate grant date fair value of awards granted during the fiscal year. Mr. Storey was granted a stock option to purchase 75,000 shares of common stock in August 2010. Stock options granted vest and become exercisable in four equal cumulative installments on each successive anniversary date of the grant and have a contractual term of ten years. The Company computes the fair value of stock option awards using the Black-Scholes option pricing model. The following assumptions were made for purposes of calculating the grant date fair value of options: options granted to Mr. Storey: expected volatility: 50.16%; dividend yield: 0.0%; risk-free interest rate: 2.00%; and expected life: 6.25 years. The fair value of stock options awarded to Mr. Storey was approximately $1.18 per option. For additional discussion of assumptions used to value stock option grants, refer to Note 13 to the Company's consolidated financial statements for the fiscal year ended December 31, 2011 in the Company's Form 10-K filed with the Securities and Exchange Commission on March 21, 2012.

(7) The amounts in this column are explained in the Other Compensation Table below.

OTHER COMPENSATION TABLE

Name	Year	401(k)	Other	Total
Thomas C. Hansen	2011	$ 8,234	$ -	$ 8,234
Chief Executive Officer	2010	$ 8,706	$ -	$ 8,706
Craig D. Storey(1)	2011	$ 5,750	$ -	$ 5,750
Chief Operating/Financial Officer	2010	$ 1,650	$ 15,000	$ 16,650
John W. O'Neil(2)	2011	$ 5,934	$ 92,248	$ 98,182
Vice President, International	2010	$ 4,845	$ 79,680	$ 84,525

(1) Mr. Storey was paid a $15,000 signing bonus in 2010 to cover moving and temporary living expenses.

(2) Other compensation for fiscal year 2011 reflected in the table above for Mr. O'Neil includes $22,792 base salary adjustments, $45,009 housing expense, $8,792 of travel expenses, $12,177 automobile lease expense and $3,478 for gross up of wages for payment of taxes. Amounts for fiscal year 2010 reflected in the table above for Mr. O'Neil includes $16,223 base salary adjustments, $44,764 housing expense, $4,268 of travel expenses, $12,653 automobile lease expense and $1,772 for gross up of wages for payment of taxes. All amounts were paid pursuant to Mr. O'Neil's employment agreement and are directly related to his relocation to Belgium to manage our international operations.

OUTSTANDING EQUITY AWARDS AT DECEMBER 31, 2011

		Option Awards				Restricted Stock Unit Awards	
Name	Grant Date	Number of Securities Underlying Unexercised Options Exercisable(1)	Number of Securities Underlying Unexercised Options Unexercisable	Option Exercise Price	Option Expiration Date	Equity Incentive Plan Awards: Number of Units That Have Not Vested(2)	Equity Incentive Plan Awards: Market Value of Units That Have Not Vested(3)
Thomas C. Hansen . . .	9/24/09	175,000	175,000	$ 2.39	9/24/19		
Thomas C. Hansen . . .	8/25/10					63,559	$ 117,584
Thomas C. Hansen . . .	3/15/11					147,261	$ 272,433
Craig D. Storey	8/25/10	18,750	56,250	$ 2.36	8/25/20		
Craig D. Storey	3/15/11					58,220	$ 107,707
John W. O'Neil	8/31/07	15,000	-	$ 9.23	8/31/17		
John W. O'Neil	8/29/08	26,250	8,750	$ 5.07	8/29/18		
John W. O'Neil	3/15/11					51,371	$ 95,036

(1) Stock options granted vest and become exercisable in four equal installments on each successive anniversary date of grant and have a contractual term of ten years.

(2) Messrs. Hansen, Storey and O'Neil were awarded restricted stock units on February 17, 2011 (with a grant date of March 15, 2011). The awards are subject to performance criteria based on earnings EPS of the Company during the period January 1, 2011 and ending December 31, 2013. The maximum number of restricted stock units subject to vesting at the grant date was 196,348 for Mr. Hansen, 77,626 for Mr. Storey and 68,494 for Mr. O'Neil. Threshold performance level was achieved for the twelve-month period beginning January 1, 2011 and ending December 31, 2011. Assuming maximum threshold performance is attained for the remaining performance period the maximum number of restricted stock units subject to vesting as of December 31, 2011 is 147,261 for Mr. Hansen, 58,220 for Mr. Storey and 51,371 for Mr. O'Neil. Mr. Hansen was awarded restricted stock units on August 25, 2010 (with a grant date of August 25, 2010). The award is subject to performance criteria based on earnings per share of the Company during the period May 1, 2010 and ending December 31, 2012. The maximum number of restricted stock units subject to vesting at date of grant was 190,678. Because threshold performance for the period May 1, 2010 through December 31, 2010, and for the period January 1, 2011 through December 31, 2011, was not achieved 127,119 restricted stock units were deemed to have been forfeited. The maximum number of restricted stock units subject to vesting as of December 31, 2011 is 63,559.

(3) The market value of unvested restricted stock unit awards was calculated by valuing each unit at $1.85, which was the closing market price of Heelys' common stock on December 30, 2011.

POTENTIAL PAYMENTS UPON TERMINATION OR CHANGE-IN-CONTROL

Employment Agreements

Thomas C. Hansen and John W. O'Neil

We entered into an employment agreement with Mr. Hansen in July of 2009. We entered into an employment agreement with Mr. O'Neil in October of 2008, which was amended on February 18, 2010. Each of the employment agreements is subject to an automatic annual one-year renewal, unless either we or the executive provides 90-day advance notice of termination before the end of the executive's term. The employment agreements entitle each executive to receive certain payments, depending on the manner in which he is terminated.

If the executive's employment is terminated by the executive's Disability, by the Company for cause (as defined in the employment agreements), by the executive upon notice of non-renewal, by the executive at any time without good reason (as defined in the employment agreements), or by the Company upon notice of non-renewal, the executive is not entitled to receive payment of any severance benefits (as defined in the employment agreements). The employment agreements, however, entitle the terminated executive, including an executive who is terminated by reason of the foregoing, to receive any unpaid salary, bonuses, reimbursable expenses, or benefits, as well as an amount equal to all unused vacation pay (in each case, subject to the terms of the applicable plan or policy).

If the executive is terminated for good reason or without cause, each of the respective employment agreements entitles the respective executive to receive an amount equal to his base salary for a period of one year for Mr. Hansen and six months for Mr. O'Neil, plus an additional period equivalent to four weeks for every year of his service to the Company in excess of five years, to be capped at 78 weeks of base salary severance. The Company will pay the severance benefits in accordance with the Company's normal payroll policies. If Mr. O'Neil accepts employment with another employer following his termination, the severance payments will be reduced to the difference (if any) between such executive's base salary as of the termination date and the executive's base compensation with such new employer, and such modified payments will be made in equal installments during the remainder of the severance period (as defined in the employment agreements). In addition, each of the executives will be reimbursed for the cost of the monthly health insurance premiums payable by such executive to maintain coverage for such executive and his dependents for up to 18 months after his termination for good reason or without cause.

If the executive is terminated without cause following a change of control (as defined in the employment agreements), he is entitled to receive an amount equal to his base salary for a period of one year plus a period equivalent to one month for every year of his service to the Company in excess of five years. Such amounts will be paid in accordance with the Company's normal payroll policies. In addition, the executive will be reimbursed for the cost of the monthly health insurance premiums payable by such executive to maintain coverage for such executive and his dependents for up to 18 months after his termination without cause following a change of control.

In the event of Mr. O'Neil's death, his estate will be entitled to receive an amount equal to the executive's then current annual base salary for a period of nine weeks, paid in accordance with the Company's normal payroll policies.

Before receiving any of the payments described above, the executive must sign a general release that releases any and all claims the executive may have against the Company. Each employment agreement prohibits the executive from disclosing our confidential or proprietary information. Such agreements also contain certain non-competition and non-solicitation provisions which restrict the executive during the term of his employment and for a period of one year (and a period of 18 months for the non-solicitation and no-hire of employees and persons having a business relationship with the Company) after the date of termination of his employment.

If Mr. O'Neil terminates his employment for good reason, or if the Company terminates him for any reason other than cause, his employment agreement provides that he is entitled to reimbursement of up to $15,000 for any airfare and relocation expenses necessary to return to the United States if he is employed at such time in Belgium. In addition, Mr. O'Neil is entitled in the event of such termination to payment or reimbursement for the lease on his personal residence in Belgium for the lesser of one year or the remainder of the then current term on his lease.

As disclosed in our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 3, 2012, on March 28, 2012, the Company notified Mr. O'Neil that his employment will be terminated, effective as of July 1, 2012. Mr. O'Neil's employment is being terminated in connection with our previously disclosed international efficiency and cost reduction initiative and the closure of our office in Brussels, Belgium, which commenced in the first quarter of 2012. Upon the effective date of Mr. O'Neil's termination, Mr. O'Neil will be entitled to receive the benefits set forth above pursuant to his employment agreement, and his severance amount will equal approximately $87,500 (representing the six month benefit described above based on his annualized current base salary of $175,000). Mr. O'Neil also will receive an additional three months of severance amounts (equaling approximately $44,000 in the aggregate), as and to the extent required by Belgian law, in accordance with the Company's normal payroll policies.

Craig D. Storey

We entered into a letter agreement dated June 2, 2010 with Mr. Storey regarding the terms of his employment. Per the letter agreement Mr. Storey would receive severance payments for a period of six months if he is dismissed without cause. If the Company dismissed Mr. Storey, in connection with a change of control of the Company occurring in the first year of Mr. Storey's employment, Mr. Storey would have received severance payments equal to one year of his annual salary then in effect at the time of his dismissal, and if the Company dismissed Mr. Storey in connection with a change of control of the Company occurring in the second and third years of Mr. Storey's employment, he would have received severance payments equal to six months of his annual salary then in effect at the time of his dismissal.

On March 16, 2012, we entered into an Executive Restrictive Covenant and Retention Agreement with Mr. Storey (the "Agreement"). Under the Agreement, Mr. Storey will be entitled to an amount equal to his then-current salary upon the earliest to occur of Mr. Storey's (1) termination without Cause (as defined in the Agreement), (2) Resignation for Good Reason (as defined in the Agreement), and (3) termination for a Disability (as defined in the Agreement). Mr. Storey will not be entitled to the severance payment if Mr. Storey is terminated for Cause. In addition, Mr. Storey will not be entitled to the severance payment until such time that he has executed a waiver and global release of claims he may have against the Company and its stockholders, subsidiaries, and affiliates, and their current and former employees.

The Agreement contains noncompetition, non-solicitation, and confidentiality and non-disclosure covenants. If Mr. Storey violates these covenants, the Company will be relieved of making the severance payment to Mr. Storey under the Agreement, and Mr. Storey must reimburse the Company for any such payment previously made to him.

If Mr. Storey intends to leave his employment of the Company for any reason, the Agreement requires that Mr. Storey must give the Company thirty (30) days' prior written notice of that intent. Mr. Storey also must provide transition assistance to the Company and its employees after giving such notice.

The Agreement supersedes the letter agreement dated June 2, 2010 with Mr. Storey.

Equity and Bonus Plans

The Company's current equity and bonus plans generally provide for payments to participants upon termination, change-in-control and certain other specified events, as follows:

Restricted Stock Unit Grants

With respect to our 2011 and 2012 awards of restricted stock units under the 2006 Plan and the respective award agreements, if a participant experiences a termination of Continuous Service (as defined in the 2006 Plan) due to death, Disability (as defined in the 2006 Plan), Retirement or Early Retirement (as such terms are defined in the participants' underlying award agreements) during the respective three (3) year performance period for each such award, then the forfeiture restrictions with respect to that participant's restricted stock units shall lapse under each award on (i) the date of termination with respect to each prior full performance year in which such participant remained in Continuous Service and (ii) December 31 of the performance year in which the participant died or became Disabled on or after July 1 of such performance year, provided the EPS performance level achieved for such performance year is at least the threshold value for such performance year (determined as of December 31 of such performance year). The number of restricted stock units that will be earned under each award by a participant that experiences a termination of Continuous Service on account of death or Disability on or after July 1 of a performance year will be determined by multiplying the applicable EPS performance level achieved for such year by a fraction, the numerator of which is the number of days in the performance year that the participant was employed (including the date of termination), and the denominator of which is 365.

With respect to our 2010, 2011 and 2012 awards of restricted stock units, if a Change in Control (as defined in the 2006 plan) occurs on, or prior to, the last day of the performance period for such award, and the participant is employed by the Company on the date of the closing of the Change in Control, the forfeiture restrictions with respect to the awards will lapse on such closing date, and the participant will vest in and have a nonforfeitable right under each award to a "Change in Control Restricted Stock Unit Award" which will be the sum of the "Completed Performance Year Award" and the "Remaining Performance Year Award." The participant's Completed Performance Year Award under each award will be determined by multiplying (i) the target number of restricted stock units awarded to the participant multiplied by a fraction the numerator of which is the number of completed performance years before the year in which the Change in Control occurs and the denominator of which is three (3), and (ii) the average of the achievement percentages that correspond to the EPS performance level achieved for each completed performance year prior to the Change in Control. The participant's remaining performance year, if any, under each award will be determined by multiplying (i) the target number of restricted stock units awarded to the participant multiplied by a fraction, the numerator of which is the number of remaining performance years in the performance period (including the performance year in which the Change in Control occurs) and the denominator of which is three (3), and (ii) the average of the achievement percentages for the remaining performance years in the performance period (including the performance year in which the Change in Control occurs) as if the EPS performance level achieved for each such year was the target level set forth above (i.e., one hundred (100) percent).

2012 Long-Term Management Incentive Plan

Under the LTMIP Award Agreements for our LTMIP, if a participant in the LTMIP experiences a termination of his Continuous Service (as defined in the LTMIP) during the LTMIP Performance Period due to the occurrence of death, Disability (as defined in the LTMIP), Retirement or Early Retirement (as defined in the LTMIP Award Agreement), the participant will remain eligible for bonus payouts under the LTMIP with respect to each prior full LTMIP Performance Year in which the participant remained in Continuous Service. If the participant experiences a termination of his Continuous Service (as defined in the LTMIP) during a LTMIP Performance Year due to the occurrence of death or Disability (as defined in the LTMIP) on or after July 1 of that LTMIP Performance Year, the participant will remain eligible for a bonus payout under the LTMIP; provided, that the EPS performance level achieved for such LTMIP Performance Year is at least the threshold value set forth in the participant's LTMIP Award Agreement; and provided further that the amount of bonus payout under the LTMIP with respect to each LTMIP Performance Year in such circumstances will be determined by multiplying the performance level percentage achieved for such year by a fraction, the numerator of which is the number of days in the LTMIP Performance Year that the participant was employed (including the date of termination) and the denominator of which is 365.

If the Company experiences a Change in Control (as defined in LTMIP), the bonus payout amounts for the LTMIP Performance Year in which the Change in Control occurs and any subsequent LTMIP Performance Year in the LTMIP Performance Period shall be calculated as if the target EPS performance level had been reached notwithstanding the Change in Control. The bonus payout amount for any completed LTMIP Performance Year shall be calculated based on the actual level of performance achieved for that completed LTMIP Performance Year.

2012 Management Incentive Bonus Plan

Each participant in our 2012 management incentive bonus plan must be employed by the Company on the last day of fiscal 2012 to be eligible to receive a bonus payout amount under the 2012 management incentive bonus plan. However, if the participant experiences a termination of his Continuous Service (as defined in the 2012 management incentive bonus plan) during fiscal 2012 due to the occurrence of death or Disability (as defined in the 2012 management incentive bonus plan) on or after July 1, 2012, the participant will remain eligible for a bonus payout under the 2012 management incentive bonus plan; provided, that at least one of the performance levels achieved for 2012 meets the threshold value set forth in the participant's 2012 management incentive bonus plan award agreement; and provided further that the amount of bonus payout under the 2012 management incentive bonus plan in such circumstances will be determined by multiplying the total bonus payout amount for such year by a fraction, the numerator of which is the number of days in 2012 that the participant was employed (including the date of termination) and the denominator of which is 365.

If the Company experiences a Change in Control (as defined in the 2012 management incentive plan), the bonus payout amounts under the 2012 management incentive bonus plan will be calculated as if 100% of the target level of performance had been reached notwithstanding the Change in Control. Payment of any accelerated bonus payout amounts under the 2012 management incentive bonus plan will be in cash in a single lump sum within ninety (90) days following the date of the Change in Control, with the exact date of payment determined by the Company.

The following table illustrates the benefits that would be received by the Named Executive Officers assuming a hypothetical termination without cause occurring on the last business day of 2011.

Termination Without Cause

Name	Salary Continuation(1)	Accrued Vacation	Health Insurance(2)	Other(3)	Total
Thomas C. Hansen	$ 430,000	$ 37,005	$ 21,420	$ -	$ 488,425
Craig D. Storey	$ 100,000	$ 3,846	$ -	$ -	$ 103,846

The following table illustrates the benefits that would be received by the Named Executive Officers assuming a hypothetical change-in-control occurring on the last business day of 2011.

Change-In-Control

Name	Salary Continuation(1)	Accrued Vacation	Restricted Stock Unit Acceleration(2)	Stock Option Acceleration(3)	Health Insurance(4)	Other(5)	Total
Thomas C. Hansen	$ 430,000	$ 37,005	$ 210,145	$ -	$ 21,420	$ -	$ 698,570
Craig D. Storey	$ 100,000	$ 3,846	$ 59,837	$ -	$ -	$ -	$ 163,683
John W. O'Neil	$ 175,000	$ -	$ 52,797	$ -	$ 15,606	$ 23,807	$ 267,210

(1) Salary continuation benefits for Messrs. Hansen and O'Neil include an amount equal to annual base salary. Salary continuation benefits for Mr. Storey include an amount equal to six months pay. Effective March 16, 2012, if there is a change-in-control, salary continuation for Mr. Storey would be equal to his annual base salary.

(2) Calculated based upon the number of restricted stock units that would vest, valued based on the closing market price of Heelys' common stock on December 30, 2011 of $1.85. Messrs. Hansen, Storey and O'Neil were awarded restricted stock units on February 17, 2011 (with a grant date of March 15, 2011). The awards are subject to performance criteria based on EPS of the Company during the period January 1, 2011 and ending December 31, 2013. The target awards granted to Messrs. Hansen, Storey and O'Neil were 98,174, 38,813 and 34,247 of restricted stock units, respectively. Threshold EPS performance level was achieved for the twelve-month period beginning January 1, 2011 and ending December 31, 2011 and therefore 16,362, 6,469 and 5,708 of restricted stock units were earned, subject to vesting, by Messrs. Hansen, Storey and O'Neil, respectively. For the remaining performance period target EPS performance level would be deemed to have been achieved increasing the number of restricted stock units earned and vested to 81,812, 32,344 and 28,539 for Messrs. Hansen, Storey and O'Neil respectively. Mr. Hansen was awarded restricted stock units on August 25, 2010 (with a grant date of August 25, 2010). The award is subject to performance criteria based on EPS of the Company during the period May 1, 2010 and ending December 31, 2012. The target award granted to Mr. Hansen was 95,339. EPS threshold performance level for the period May 1, 2010 through December 31, 2010, and for the period January 1, 2011 through December 31, 2011, was not achieved. If target EPS performance level is achieved for the remaining period, 31,780 of the restricted stock units would vest.

(3) Calculated as the intrinsic value per option, multiplied by the number of options that become immediately vested upon a change in control. The intrinsic value per option is calculated as the excess of the closing market price of Heelys' common stock on December 30, 2011 of $1.85 per share over the exercise price of the option. If the closing market price is less than the exercise price there is no intrinsic value. The following number of options would have immediately vested upon change of control:

Name	Grant Date	Number of Options	Exercise Price	Closing Market Price	Intrinsic Value	Total Intrinsic Value
Thomas C. Hansen	9/24/09	350,000	$ 2.39	$ 1.85	$ (0.54)	$ -
Craig D. Storey	8/25/10	75,000	$ 2.36	$ 1.85	$ (0.51)	$ -
John W. O'Neil	8/31/07	15,000	$ 9.23	$ 1.85	$ (7.38)	$ -
John W. O'Neil	8/29/08	35,000	$ 5.07	$ 1.85	$ (3.22)	$ -

(4) Estimated current cost of the health insurance premiums to maintain coverage for the Named Executive Officer and their dependents for 18 months. For Mr. Hansen the estimated cost of the health insurance premiums is net of all premium costs (if any) executive would have paid had executive's employment continued. Mr. Storey does not participate in the Company's health insurance plan.

(5) Estimated costs to pay, or reimburse, Mr. O'Neil for the lease on his personal residence in Belgium ($8,807) and reimbursement of airfare and reasonable relocation expenses back to the United States ($15,000).

The following tables illustrate the benefits that would be received by the Named Executive Officers assuming a hypothetical death or disability occurring on the last business day of the fiscal year ended December 31, 2011.

Death

Name	Salary Continuation(1)	Accrued Vacation	Restricted Stock Units(2)	Other(3)	Total
Thomas C. Hansen....	$ -	$ 37,005	$ 30,270	$ -	$ 67,275
Craig D. Storey.....	$ -	$ 3,846	$ 11,968	$ -	$ 15,814
John W. O'Neil.....	$ 30,288	$ -	$ 10,560	$ 23,807	$ 64,655

Disability

Name	Salary Continuation(1)	Accrued Vacation	Restricted Stock Units(2)	Other(3)	Total
Thomas C. Hansen....	$ -	$ 37,005	$ 30,270	$ -	$ 67,275
Craig D. Storey.....	$ -	$ 3,846	$ 11,968	$ -	$ 15,814
John W. O'Neil.....	$ -	$ -	$ 10,560	$ 23,807	$ 34,367

(1) Salary continuation benefits include an amount equal to nine weeks of executive's base salary, payable in installments in accordance with the normal payroll policies of the Company. Only Mr. O'Neil is eligible for salary continuation. There is no salary continuation in the case of disability. Effective March 16, 2012, if Mr. Storey is terminated due to disability he would receive salary continuation benefits in an amount equal to his annual base salary.

(2) Messrs. Hansen, Storey and O'Neil were awarded restricted stock units on February 17, 2011 (with a grant date of March 15, 2011). The awards are subject to performance criteria based on EPS of the Company during the period January 1, 2011 and ending December 31, 2013 (the "Performance Period"). EPS will be determined by dividing the Company's consolidated net income or loss by the number of basic common shares of the Company for each of the twelve-month periods beginning January 1 and ending December 31 for 2011, 2012 and 2013 (each, a "Performance Year"). Each underlying award agreement provides that if the participant experiences a termination of Continuous Service due to death or Disability (as defined in the 2006 Plan) during the Performance Period, then the forfeiture restrictions with respect to that participant's restricted stock units shall lapse on (i) the date of termination with respect to each prior full Performance Year in which such participant remained in Continuous Service, and (ii) December 31 of the Performance Year in which the participant died or became Disabled on or after July 1 of such Performance Year, provided the EPS performance level achieved for such Performance Year is at least the threshold value. The number of restricted stock units that will be earned by a participant that experiences a termination of Continuous Service on account of death or Disability on or after July 1 of a Performance Year is determined by multiplying the applicable performance level achieved for such year by a fraction, the numerator of which is the number of days in the Performance Year that the participant was employed (including the date of termination), and the denominator of which is 365. Threshold EPS performance level was achieved for the twelve-month period beginning January 1, 2011 and ending December 31, 2011. Therefore, assuming a hypothetical termination due to death or disability occurring on the last business day of the fiscal year ended December 31, 2011 restricted stock units would be earned, and vested: 16,362 (for Mr. Hansen), 6,469 (for Mr. Storey) and 5,708 (for Mr. O'Neil). The amount in the table above was calculated based upon the number of restricted stock units that would vest valued based on the closing market price of Heelys' common stock on December 30, 2011 of $1.85.

(3) Estimated costs to pay, or reimburse, Mr. O'Neil for the lease on his personal residence in Belgium ($8,807) and reimbursement of airfare and reasonable relocation expenses back to the United States ($15,000).

AUDIT COMMITTEE REPORT

The following is the report of the Audit Committee with respect to the Company's audited financial statements presented in its Annual Report on Form 10-K for the fiscal year ended December 31, 2011, which include the consolidated balance sheets of the Company as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income(loss) and cash flows for each of the two years in the period ended December 31, 2011, and the notes thereto.

The Audit Committee of the Board of Directors is composed of Richard F. Strup, Jerry R. Edwards and N. Roderick McGeachy, III, all of whom have been determined by the Board to be independent as required by the listing rules of the Nasdaq Stock Market.

The Audit Committee acts under a written charter approved by the Board. A complete copy of the Audit Committee's charter is posted on the Investor Relations page at the Company's website at www.heelys.com under the heading "Governance" and the sub-heading "Committees & Charters." As stated in its charter, the Audit Committee assists the Board in monitoring the integrity of the Company's financial statements and independent registered public accounting firm's qualifications and independence. In carrying out these responsibilities, the Audit Committee met with the Company's management periodically to consider the adequacy of the objectivity of its financial reporting. The Audit Committee discussed these matters with Grant Thornton LLP, the Company's independent registered public accounting firm, and with the appropriate financial personnel.

The Audit Committee reviewed with management and the independent registered public accounting firm the Company's 2011 audited financial statements and met with both management and the independent registered public accounting firm to discuss and review those financial statements and reports prior to issuance. Management has the primary responsibility for the Company's financial statements and the overall reporting process, including the Company's system of internal controls over the financial reporting. Management has represented and Grant Thornton LLP has indicated in its opinion to the Audit Committee that the financial statements were prepared in accordance with generally accepted accounting principles and fairly present, in all material respects, the financial condition and results of operations of the Company.

The Audit Committee also received from, and discussed with, the independent registered public accounting firm the written disclosures and letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees). These items relate to that firm's independence from the Company. As part of its efforts to ensure the independence of Heelys' independent registered public accounting firm, the Audit Committee maintains a policy requiring the pre-approval by the Audit Committee of all services to be provided by the independent registered public accounting firm, and reviews all services actually performed by the independent registered public accounting firm in connection with its discussions regarding the independent registered public accounting firm's continued independence. The Audit Committee also discussed with the independent registered public accounting firm the matters required to be discussed by Statement on Auditing Standards Nos. 114 (The Auditor's Communication with those Charged with Governance), 115 (Communicating Internal Control Related Matters Identified in an Audit) and 116 (Interim Financial Information).

Based on the review and discussions referred to above, the Audit Committee recommended to the Board of Directors that the Company's audited financial statements be included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011 for filing with the Securities and Exchange Commission.

MEMBERS OF THE AUDIT COMMITTEE
Richard F. Strup , Chairman
Jerry R. Edwards
N. Roderick McGeachy, III

Notwithstanding anything to the contrary set forth in any of the Company's previous filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, which might incorporate future filings made by the Company under those statutes, the preceding Audit Committee Report shall not be deemed to be "soliciting material" or to be "filed" with the Securities and Exchange Commission; nor will such information be incorporated by reference into any of those prior filings, nor will such report be incorporated by reference into any future filings made by the Company under those statutes.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Since January 1, 2011, there has not been, nor is there currently proposed, any transaction or series of similar transactions to which we were or are to be a party in which the amount involved exceeds $120,000 and in which any director, nominee for director, executive officer or holder of more than 5% of our common stock, or an immediate family member of any of the foregoing, had or will have a direct or indirect interest other than:

- employment agreements with certain executive officers, which are discussed above under the caption "Executive Compensation;"
- compensation paid/to be paid to Jerry R. Edwards, N. Roderick McGeachy, III , Ralph T. Parks and Richard F. Strup for their service as a director, which is discussed above under the caption "Director Compensation;" and
- the transaction described below.

Agreement with Capital Southwest Venture Corporation

CSVC, which is a wholly owned subsidiary of Capital Southwest Corporation, beneficially owns more than 5% of our outstanding common stock.

In September 2006, we entered into an agreement with CSVC and certain of our other stockholders pursuant to which CSVC has the contractual right to designate (i) two persons to be included in management's slate of director nominees so long as it owns at least 15% of the outstanding shares of our common stock, and (ii) one such nominee so long as it owns at least 10%, but less than 15%, of the outstanding shares of our common stock. CSVC has designated Gary L. Martin and Glenn M. Neblett, both of whom are currently directors, as its designees for nomination to our Board.

Mr. Martin is President, Chief Executive Officer and the Chairman of the board of directors of Capital Southwest Corporation. Mr. Neblett is a Vice President at Capital Southwest Corporation.

PRINCIPAL ACCOUNTING FEES AND SERVICES

Grant Thornton has been the Company's independent registered public accounting firm since June 30, 2009. The Audit Committee has selected Grant Thornton as the Company's independent registered public accounting firm for the Company's fiscal year ending December 31, 2012. We expect representatives from Grant Thornton will be present at the Annual Meeting, will have an opportunity to make a statement if they wish and will be available to respond to appropriate questions.

Aggregate fees for professional services rendered by Grant Thornton for the years ended December 31, 2011 and 2010 were as follows:

	2011	2010
Audit Fees	$ 299,355	$ 289,825
Audit-Related Fees	-	-
Tax Fees	-	-
All Other Fees	-	-
Total Fees	$ 299,355	$ 289,825

Audit Fees

Audit Fees were fees (and expenses) billed for professional services rendered for the audit of the Company's consolidated financial statements and review of the interim condensed consolidated financial statements included in quarterly reports and services that are normally provided by the Company's independent registered public accounting firm in connection with statutory and regulatory filings or engagements. Audit Fees for the year ended December 31, 2010 include $2,950 in fees billed for professional services rendered in connection with the Registration Statement on Form S-8 filed in May 2010 and $4,770 in fees (and expenses) billed for professional services rendered in connection with the Registration Statement on Form-3 filed in September 2010.

Audit-Related Fees

We did not engage Grant Thornton for any audit-related services in 2011 or 2010.

Tax Fees

We did not engage Grant Thornton for any professional services rendered in connection with tax compliance, tax advice or tax consulting in 2011 or 2010.

All Other Fees

We did not engage Grant Thornton for any other services in 2011 or 2010.

Under the Audit Committee's charter, the Audit Committee must pre-approve all audits and, as required by law or regulation, any non-audit services provided by the Company's independent registered public accounting firm and must not engage the Company's independent registered public accounting firm to perform the specific non-audit services proscribed by law or regulation. The Audit Committee may delegate pre-approval authority to one or more members of the Audit Committee, acting as a subcommittee or otherwise. The decisions of any member or members to whom pre-approval authority is delegated must be presented to the Audit Committee at its next scheduled meeting. All services were pre-approved by the Audit Committee.

OTHER BUSINESS

The Board does not intend to present any business at the meeting other than the matters specifically set forth in this Proxy Statement and knows of no other business scheduled to come before the meeting. If any other matters are brought before the meeting, the persons named as proxies will vote on such matters in accordance with their judgment of the best interests of Heelys and its stockholders. The proxies solicited by Heelys will confer discretionary authority on the persons named therein as proxies to vote on any matter presented at the meeting of which the Board did not have knowledge a reasonable time before Heelys printed and mailed these proxy materials.

STOCKHOLDER PROPOSALS FOR 2013 ANNUAL MEETING

If you intend to submit a stockholder proposal and request its inclusion in the 2013 proxy statement and form of proxy, such submission must be in writing and received by us no later than December 15, 2012 but no earlier than November 15, 2012. Any such proposal must comply with our By-Laws and the requirements of Rule 14a-8 promulgated under the Securities Exchange Act of 1934, as amended.

Section 13 of Article 2 of our By-Laws provides that stockholders seeking to bring business before an annual meeting of stockholders, or a special meeting in lieu of an annual meeting, or to nominate candidates for election as directors at an annual meeting of stockholders or a special meeting to elect directors, must provide us with timely written notice of their proposal. To nominate any candidate for election as a director at any annual meeting of stockholders to elect any directors, a stockholder's notice must be delivered to or mailed and received at our principal executive offices not less than 120 nor more than 150 days before the date in the current year that corresponds to the date that we released our proxy statement to stockholders for the previous year's annual meeting. If, however, no meeting was held in the prior year, no proxy statement was released to stockholders for the prior year's meeting or the date of the annual meeting has been changed by more than 30 days from the date contemplated in the notice of annual meeting, notice by the stockholder in order to be timely must be received no later than the close of business on the 90th day before the date of the annual meeting or on the tenth day following the day on which the date of the annual meeting is first publicly announced or disclosed (including by sending or transmitting notice of the meeting), whichever is earlier. To be timely to nominate any candidate for election as a director at any special meeting of stockholders to elect any directors, a stockholder's notice must be delivered to and received at our principal executive offices no later than the tenth day following the day on which the date of the special meeting and the number of directors to be elected at that meeting is first publicly announced or disclosed.

Our By-Laws also specify requirements as to the form and content of a stockholder's notice. Subject to the foregoing, our By-Laws specifically acknowledge CSVC's right to nominate directors in accordance with the agreement between CSVC and us.

ANNUAL REPORT TO STOCKHOLDERS AND FORM 10-K

Our 2011 Annual Report to Stockholders, including financial statements for the year ended December 31, 2011, accompanies this Proxy Statement. Stockholders who wish to obtain an additional copy of our Annual Report and/or a copy of the Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2011, may do so without charge by viewing these documents on our website at http://investors.heelys.com or by writing to: Corporate Secretary, Heelys, Inc., 3200 Belmeade Drive, Ste 100, Carrollton, Texas 75006.

By Order of the Board of Directors:

Barbara A. Nagy
Corporate Secretary

April 13, 2012

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

FORM 10-K

(Mark One)

_ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OFTHE SECURITIES EXCHANGE ACT OF 1934**
For the Fiscal Year Ended December 31, 2011
Or

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

For the transition period from to

Commission file number: 001-33182

HEELYS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	75-2880496
(State of incorporation)	(I.R.S. Employer Identification No.)

3200 Belmeade Drive, Suite 100
Carrollton, Texas 75006
(Address of principal executive offices) (Zip Code)

(214) 390-1831
(Registrant's telephone number, including area code)

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 $0.001	The Nasdaq Stock Market LLC

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes _ No †

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

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

Large accelerated filer † Accelerated filer † Non-accelerated filer † Smaller reporting company _
(Do not check if a smaller reporting company)

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

As of June 30, 2011, the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the registrant's common stock held by non-affiliates was approximately $37.4 million (based upon the closing price for the registrant's common stock on The Nasdaq Stock Market of $2.28 per share). For the purpose of the foregoing calculation only, all directors and executive officers of the registrant and owners of more than 5% of the registrant's common stock are assumed to be affiliates of the registrant. This determination of affiliate status is not necessarily conclusive for any other purpose.

As of March 12, 2012, there were 27,571,052 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this Report, to the extent not set forth herein, is incorporated herein by reference from the registrant's definitive proxy statement relating to the Annual Meeting of Stockholders to be held in 2012, which definitive proxy statement shall be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year to which this Report relates.

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Cautionary Note RegardingForward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the “Securities Act,” and Section 21E of the Securities Exchange

remained a part of youth culture for more than 40 and 25 years, respectively. Our HEELYS-wheeled footwear, which we believe has broad patent protection relative to other wheeled sports products, appeals to many of these same consumers.

We believe our products appeal to a broad range of young, active consumers around the world who enjoy wheeled sports activities. The primary market for HEELYS-wheeled footwear is five to fourteen year-old boys and girls.

Products

Our primary product is HEELYS-wheeled footwear, patented, dual-purpose footwear that incorporates a stealth, removable wheel in the heel. HEELYS-wheeled footwear allows the user to seamlessly transition from walking or running to rolling by shifting weight to the heel. Users can remove the wheel to transform HEELYS-wheeled footwear into street footwear. HEELYS-wheeled footwear is offered in more than 20 styles, incorporating various comfort and performance features and colors at multiple retail price points. We traditionally offer a new line of HEELYS-wheeled footwear twice each year for the spring/summer selling season and the back-to-school/holiday selling seasons.

HEELYS-wheeled footwear can be classified into the following three categories:

Single-Wheel. Our single-wheel HEELYS-wheeled footwear has one detachable wheel and are available in various sizes for men, women and children. We offer wheels of various performance capabilities in order to appeal to beginners and advanced users. In addition to offering standard styles, we may collaborate with certain of our retail customers to develop HEELYS-wheeled footwear styles that these retail customers have the exclusive rights to sell. These special make-up programs enable these retail customers to differentiate their HEELYS-wheeled footwear product offerings and allow us to broaden our product range.

Two-Wheel. Our two-wheel HEELYS-wheeled footwear includes two detachable wheels, are designed for novice users and are offered only in children's sizes. The two-wheel HEELYS-wheeled footwear has been sold primarily in Japan; however, in 2010 we started selling this product domestically through key retailers and through our website.

Grind-and-Roll. Grind-and-roll HEELYS-wheeled footwear represents our highest performance category and are preferred by enthusiasts seeking a challenging and exciting action sports experience. This category features a single detachable wheel and a patented, hard nylon plate in the arch, enabling the consumer to slide, or "grind," on hand railings and other similar surfaces. Consumers can use our grind-and-roll HEELYS-wheeled footwear to perform distinctive maneuvers, similar to those performed by skateboarders and inline skaters.

In 2011, we introduced Sidewalk Sports™ wheeled footwear. The Sidewalk Sports™ branded products will be sold in markets in which we lack protection of our intellectual property or where the level of expendable income of the average consumer does not support the purchase price of our HEELYS-wheeled footwear. We also plan to sell the product in the U.S., Japan and Europe in traditional mass retailers. In the fourth quarter of 2011, the two-wheeled Sidewalk Sports™ product was sold in the U.S. exclusively at Kmart stores. That exclusivity ended January 1, 2012.

Product Design and Development

We attempt to update and refine our product offerings in response to evolving consumer preferences. We believe that introducing new products, performance features and designs better positions us to achieve targeted price points, drive incremental consumer demand for our products and encourage repeat purchases. We attempt to monitor changing consumer trends and identify new product opportunities through contact with our target consumers and dialogue between our sales representatives and our retail customers.

Our product development efforts include both incremental improvements to our existing products and entirely new technologies aimed at increasing the overall visual appeal and product function while simultaneously lowering our production costs.

Sales

We control the distribution of our products in an effort to protect our HEELYS brand and maintain our targeted price points. We sell our products domestically directly to retail customers. Internationally, while we have traditionally sold our products through independent distributors, since 2008, we have expanded our international opportunities through our Belgian subsidiary by working more closely with our distributors, establishing relationships with distributors in new international markets and, in select markets, selling our products direct to retail customers. We began taking steps in the first quarter of 2012 to close our office in Brussels, Belgium and transition our business operations conducted through that office to our French and German offices. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011.

During the second quarter of 2010, we began selling certain of our products directly to consumers through our website at www.heelys.com.

Currently, we do not sell, other than the limited amount of sales through our website, directly to consumers. We sold certain styles to select discount retailers in order to reduce our inventory levels and dispose of excess inventory in 2009. Sales to discount retailers declined in 2010 and 2011 due to our lower inventory levels.

Domestic Sales

Our products are sold through retail customers, including a variety of full-line sporting goods retailers, specialty apparel and footwear retailers, family footwear stores and select online retailers. We attempt to choose retail customers who appeal to our target market and who are able and willing to merchandise our products in a manner we believe is consistent with our brand message and positioning. Academy, Big 5, Kids Footlocker, Journeys, Kmart, Finish Line, Shoe Carnival, Zappos.com and Amazon.com are examples of our domestic retail customers. In 2011 and 2010, our domestic net sales were $11.9 million and $8.6 million, respectively, representing 37.2% and 28.4% of our consolidated net sales, respectively.

We actively manage our domestic distribution by controlling the number of stores in which HEELYS-wheeled footwear is sold.

We are committed to providing the highest levels of service to our retail customers. Historically, our domestic retail accounts have been served by a national sales force of sales representatives employed by independent sales agencies, with each independent sales agency being assigned an exclusive territory and compensated on a commission basis. In 2011, our domestic retail accounts were served by a national sales force of sales representatives employed by a single independent sales agency. Our external sales force is responsible for substantially all of our domestic sales.

International Sales

As of December 31, 2011, we offered our products internationally through 23 independent distributors, each of which has exclusive rights to a designated territory. We select our independent distributors based on their relationships with appropriate retailers, their ability to effectively represent the HEELYS brand and their execution of our distribution strategy. In order to maintain a consistent brand image throughout the world, we provide marketing, distribution and product training support to our independent distributors. Each distributor must generally meet minimum sales goals and is responsible for funding its local marketing campaigns, maintaining its own inventory and providing sufficient sales, distribution and customer service infrastructure.

During the first quarter of 2008, we formed a Belgian subsidiary, with offices in Belgium, Germany and France, to focus on expanding our international opportunities by working more closely with our distributors, establishing relationships with distributors in new international markets and, in select markets, selling our products direct to retail customers. We took over the distribution of our products in Germany and Austria (the "German market"), effective April 1, 2008, and in France, Monaco and Andorra (the "French market"), effective May 1, 2008. In 2011, our German and French markets accounted for approximately 6.8% and 17.0% of our consolidated net sales, respectively. In 2010, our German and French markets accounted for 12.4% and 21.4% of our consolidated net sales, respectively.

During the fourth quarter of 2009, we began to sell directly to retailers in Italy through our Belgian subsidiary. In 2011 and 2010, our Italian market accounted for approximately 19.6% and 8.4% of our consolidated net sales, respectively.

During 2011, we began to sell directly to retailers in Spain and Portugal also through our Belgian subsidiary. For 2011 and 2010, sales in these markets have been limited.

We began taking steps in the first quarter of 2012 to close our office in Belgium and transition our business operations conducted through that office to our French and German offices.

In 2010, our largest international territory managed by an independent distributor was Japan, which accounted for 17.7% of our consolidated net sales. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011. In 2011, sales in our Japanese market accounted for approximately 5.9% of our consolidated net sales.

In 2011 and 2010, our international net sales were $20.1 million and $21.8 million, respectively, accounting for 62.8% and 71.6% of our consolidated net sales, respectively. The decline in sales in our international markets is primarily attributable to a decrease in sales in our Japanese market.

We believe international distribution represents a growth opportunity for us that we intend to take advantage of by encouraging our existing distributors to expand their market presence, by establishing relationships with distributors in new international markets and, in select markets, selling our products direct to retail customers.

In our international markets we employ third party distributors in most countries and those distributors have their own direct and independent sales representatives. In our German, French, Italian and Spain/Portugal markets, where we sell directly to retailers, we sell our products through independent sales representatives. In our Japanese market, where we began to sell directly to retailers effective March 1, 2011, we sell our products through employed sales staff.

Principal Customers

In 2011 and 2010, Oxylane Group accounted for 11.7 % and 11.9% of our consolidated net sales, respectively. Oxylane Group is a French sporting goods retail chain operating under the name Decathlon.

In 2010, Privee AG Corporation accounted for 17.7% of our consolidated net sales. Privee AG Corporation ("Privee") was the Company's independent distributor in Japan. On February 28, 2011 our distributor agreement with Privee was terminated. Sales to Privee decreased $2.2 million, or 29.4%, to $5.4 million in 2010, from $7.6 million in 2009. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011.

No other retail customer or independent distributor accounted for 10% or more of our net sales in either of fiscal years 2011 or 2010.

Marketing

Our marketing strategy is to position our products and the HEELYS brand to represent a lifestyle that allows our consumers to have Freedom and Fun with the sense that they are Fearless, providing them a sense of excitement and individuality. We utilize a multi-faceted strategy to promote awareness of, and generate demand for, the HEELYS brand. This strategy includes a mix of mass advertising, point-of-purchase, or "POP," displays, product placement, targeted licensing agreements and partnerships, public relations, celebrity/influential product trials and experiential marketing activities. While we fund the cost of these activities domestically, as well as in our direct distribution international markets, our international independent distributors are solely responsible for these costs in their respective markets.

Television Advertising

Television advertisements have traditionally been an important and effective tool for increasing awareness of our brand and products among our target consumers because these advertisements allow us to show consumers HEELYS-wheeled footwear in action. Advertisements have aired nationally and in selected regions of the United States, Europe and Japan during our primary selling seasons. As part of our regional television advertising strategy, we typically feature the name of a local retail customer at the end of our television advertisements. This tactic is intended to drive consumers to specific retail customers and allow us to evaluate the effectiveness of our advertising.

Point-of-Purchase Displays

Many of our retail customers have committed valuable floor space to HEELYS branded POP displays. When the opportunity presents itself, we supply custom POP solutions that best fit both our needs and those of our retail customers. Through the use of these POP displays, we are able to present the HEELYS brand message to consumers in a consistent manner and sometimes increase our shelf space in our retail customers' locations. POP displays are used in those markets where we sell directly to retailers. Our POP displays are scalable, to give a consistent look while adhering to the size differences at individual retail locations.

Product Placement

Kids, Tweens and Teens look to celebrities, musicians and other stars for inspiration and fashion cues. Therefore, we identify and secure, through our agency relationships, "product-in-use" opportunities for our domestic and international markets ranging from feature films to television and celebrity endorsement. We believe product placement activities enable us to build awareness of, and demand for, our products in a cost-effective manner.

Targeted Licensing Agreements and Partnerships

As our target demographic looks for inspiration from the celebrity world, our consumers are also fans of sporting teams and other corporations that market their products to our same customer. Partnerships and licensing agreements allow us to communicate with consumers, along with other non-competing brands, in an effort to establish a broader relationship with the consumer. It also allows us to get the most of our marketing funds by working with other brands that want to send the same or similar message.

Cooperative Marketing

In partnership with our retailers to whom we sell direct to, whether it be domestic or international, we offer cooperative marketing support. Our cooperative marketing initiatives are aimed at increasing overall demand for HEELYS, as well as driving HEELYS sales to our key retail partners. Examples of cooperative marketing include company-approved POP display materials, television, radio, print and web-based advertising, gift with purchase promotions and customized event marketing demonstrations. We will continue to collaboratively work with our retail partners in an effort to drive the overall awareness and demand for HEELYS.

Website

We recently redesigned and upgraded the www.heelys.com website to provide a more interesting, informative and fun site for the online community of HEELYS users. The redesigned website allows HEELYS to have an on-line store for select products. In addition, the redesigned and upgraded website allows us to advertise one main URL to have a global look and feel, allowing our international offices to modify language and specific product information while keeping the same branded look that allows our consumers to choose their country and language.

Manufacturing and Sourcing

We do not own or operate any manufacturing facilities and we purchase our products as finished goods from independent manufacturers. We do not have any long-term manufacturing contracts, choosing instead to retain the flexibility to change our manufacturing sources if necessary. We believe alternate manufacturing or supply sources are available at comparable costs to those we currently utilize.

We monitor all aspects of the production of our HEELYS-wheeled footwear, including the development and manufacturing of prototypes, initial production runs and final product manufacturing. We perform an array of inspection procedures at various stages of the production process, including examination and testing of raw materials and components prior to manufacture, work-in-process at various stages of production and finished goods prior to shipment. Historically, our defective return rate has been less than 1.0% of our net sales.

In May 2010, we entered into an agreement with TGB, LLC, a New Jersey limited liability company ("TGB"), under which TGB acted as the exclusive sourcer of our shoe products. In April 2011, we reached an agreement to terminate our sourcing agreement with TGB. From and after the termination of that sourcing agreement, we were not required to (and did not) purchase any other products from TGB under the sourcing agreement and, instead, we purchased products directly from our independent manufacturers.

Order Fulfillment and Inventory Management

Our products are inspected, bar coded and packaged by our independent manufacturers. Our independent manufacturers mark, label and pre-ticket our products for certain of our larger retail customers. The product is then transported either to the port in Long Beach, California, to a third-party distribution facility in Belgium, to a third-party distribution facility in Tokyo, or directly to the customer.

For products shipped to the United States, after the products clear U.S. customs, we use an independent freight forwarder and customs broker to ship them via rail by container to our distribution center located in Carrollton, Texas or directly to our retail customers. Upon receipt at our warehouse, merchandise is inspected and recorded in our management information systems and packaged for delivery. We maintain electronic data interchange, or "EDI," connections with many of our larger retail customers in order to automate order tracking and inventory management.

Before establishing our Belgian subsidiary, substantially all of our products destined for international distribution were sent directly by our independent manufacturers to our independent distributors. Through our Belgian subsidiary, we have expanded the use of a third-party distribution facility in Belgium to help facilitate fulfillment of orders to international customers, and some products destined for sale through our Belgian subsidiary are sent to this third-party distribution facility.

In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011. We use a third-party distribution facility in Japan to help facilitate fulfillment of orders to our retail customers in Japan.

To allow us to better plan our production volume with our manufacturers, we offer our retail customers discount incentives to place advance orders. Historically, we received most of our orders three to four months in advance of the scheduled delivery dates. Our retail customers have been, and continue to be, cautious when placing orders and have shifted towards shorter lead times and at-once inventory purchases. This has transferred more of the risk of purchasing and carrying inventory to us. We seek to manage our inventory risk by monitoring available sell-through data and seeking input on anticipated consumer demand from our retail customers.

Intellectual Property—Patents and Trademarks

We have both domestic and international patent coverage for the technology incorporated in our HEELYS-wheeled footwear and own more than 84 issued patents and pending patent applications in more than 25 countries, of which more than 55 are related to wheeled footwear. Our first patent was a method patent that was issued in June 2002 and includes coverage for wheeled footwear, including HEELYS-wheeled footwear, with a wheel in the heel that allows the user to transition from walking or running to rolling by shifting weight to at least one wheel in the heel. We also own a variety of trademarks, with more than 109 registered and pending trademarks with rights in more than 60 countries.

We have vigorously enforced, and expect to continue to vigorously enforce, our intellectual property rights against infringers domestically and internationally. Despite the challenges inherent in combating infringers in international jurisdictions that may not protect intellectual property rights to the same extent as the United States, we have cooperated with the appropriate authorities and they have conducted successful raids, customs seizures and product confiscations of products that infringe our intellectual property rights in various countries. We have obtained agreements from importers and retailers to cease and desist all infringing activities and, in some cases have been paid monetary compensation. We have also successfully asserted our patent rights against manufacturers of infringing products.

Seasonality

Similar to other vendors of footwear products, sales of our products are subject to seasonality. There are three major buying seasons in footwear: spring/summer, back-to-school and holiday. We offer two primary lines: spring/summer and a combined back-to-school/holiday line. A few new styles will typically be added for the holiday season. Shipments for spring/summer take place during the first quarter and early weeks of the second quarter, shipments for back-to-school generally begin in May and finish in late August and shipments for the holiday season begin in October and finish in early December. Historically, we have experienced greater revenues in the second half of the year than those in the first half due to a concentration of shopping around the back-to-school and holiday seasons.

Employees

As of December 31, 2011, we employed a total of 47 full-time employees. We are not a party to any labor agreements and none of our employees are represented by a labor union.

Insurance and Product Liability

We purchase insurance to cover standard risks associated with our business, including policies to cover commercial general liability and other casualty and property risks. Our insurance rates depend upon our safety record as well as trends in the insurance industry.

We face an inherent risk of exposure to personal injury or product liability claims if, among other things, use of our products results in injury, disability or death. We believe our insurance coverage is sufficient for the risks relating to our products. Our coverage involves retentions with primary and excess liability coverage above the retention amount.

We retain certain property and casualty risks based on our analysis of the risk, the frequency and severity of a loss and the cost of insurance for the risk. We believe the risk we have assumed through retention is not significant and payments of retained claims will not have an adverse impact on our performance.

Information Technology Systems

Our information technology systems are designed to provide us with, among other things, comprehensive order processing, production, accounting and management information for the sourcing, importing, distribution and marketing aspects of our business. We maintain an EDI system that provides a computer link between us and certain of our customers, which enables us to monitor their purchases, inventory and retail sales and also improves our efficiency in responding to their needs. Although we believe our information technology systems are sufficient to meet our current needs, in June 2011 we migrated our information technology systems, located in our Texas headquarters, from Microsoft Solomon to Microsoft Navision. Our Belgian subsidiary's operations are currently, and our operations in Japan will be, operating on the Microsoft Navision platform. We believe having all of our operations on the same platform will allow for more seamless sharing of information and implementation of standardized best practices for our industry and software platform. However, we will continue to assess the need to expand and upgrade our information technology systems to support actual or expected future needs.

Competition

We compete with companies that focus on the young consumer across a number of markets, including footwear, sporting goods and recreational products. Many of these companies have substantially greater financial, distribution and marketing resources than we have. Product design, performance, styling, comfort, quality, brand awareness, timeliness of product delivery and pricing are all important elements of competition in the markets for our products. We believe the strength of our HEELYS brand, the intellectual property related to the design of HEELYS-wheeled footwear, the quality of our products and our relationships with retailers and distributors allow us to compete effectively in the markets we serve. In certain international markets, where enforcing our intellectual property rights is more difficult than in the United States, and occasionally in the domestic market, we compete against counterfeit, knockoff and infringing products, which typically are offered at lower prices.

Backlog

Historically, we received most of our orders three to four months prior to the date the products were shipped to customers. At December 31, 2011, our backlog was approximately $5.4 million, compared to approximately $4.9 million at December 31, 2010. Although generally these orders are not subject to cancellation prior to the date of shipment, cancellations have and may continue to occur. In the current economic environment, our retail customers are being cautious when placing orders and have shifted towards shorter lead times and at-once inventory purchases. For a variety of reasons, including the timing of release dates for our product offerings, shipments, order deadlines and receipt of orders, backlog may not be a reliable measure of future sales and may not be comparable from one period to another.

Item 1A. Risk Factors

Before deciding to purchase, hold or sell our common stock, you should carefully consider the risks described below in addition to the more detailed description of our business and other cautionary statements and risks described elsewhere, and the other information contained in this Annual Report on Form 10-K and in our other filings with the SEC, including our subsequent reports on Forms 10-Q and 8-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also affect our business. If any of these known or unknown risks or uncertainties actually occurs with material adverse effects on us, our business, financial condition and results of operations could be seriously harmed. In that event, the market price for our common

stock will likely decline, and you may lose all or part of your investment. Our business, prospects, financial condition or results of operations could be materially and adversely affected by the following:

We depend primarily upon sales from a single product line and the absence of continued demand for our products would have a material adverse effect on our net sales and results of operations.

In both 2011 and 2010, we generated approximately 98% of our consolidated net sales from our HEELYS-wheeled footwear and we expect to continue to depend upon HEELYS-wheeled footwear for substantially all of our consolidated net sales in the foreseeable future. Because we are currently dependent on a single line of products, factors such as changes in consumer preferences may have a disproportionately greater impact on us than if we offered multiple product categories. If consumer interest in HEELYS-wheeled footwear or wheeled sports activity products in general continues to decline, we would likely experience a further loss of sales, cancellation of orders from customers, loss of customers, excess inventories, higher reserves for marketing discretionary fund assistance, increased reserves for inventory returns, inventory markdowns and discounts to our retail customers, deterioration of our brand image, and lower revenues and gross and operating margins as a result of price reductions and may be forced to liquidate excess inventories at a discount, any or all of which would have a material adverse impact on our business and operations. There can be no assurance our products will hold long-term consumer appeal.

If we are unable to enforce our patents, trademarks and other intellectual property rights, competitors may be able to sell products that are substantially similar to our products, which could adversely affect our sales and damage our brand image.

We believe our trademarks, trade names, copyrights, trade secrets, issued and pending patents, trade dress and designs are valuable and integral to our success. The costs associated with obtaining and maintaining our intellectual property rights and protecting our HEELYS brand are significant. Further, we do not know whether our pending or future patent applications will result in the issuance of patents. Even if patents are issued in the future, we cannot predict how the patent claims will be construed and such patents may not provide us with the ability to prevent the development, manufacturing or marketing of infringing products. Enforcement of our patents and other intellectual property rights is often met with defenses, counterclaims and countersuits attacking the validity and enforceability of our patents and other intellectual property rights. The validity and enforceability of our patents may be challenged by third parties for many different reasons, including for example, prior art, prior disclosure, prior offers to sell, incorrect inventorship, prior invention by another, patent misuse, antitrust violations, laches and estoppel.

In addition, we may not be able to detect infringement of our intellectual property rights quickly or at all, and at times in the past we have not been, and we may not be, successful combating counterfeit, infringing or knockoff products, thereby damaging our competitive position. For example, on many occasions, we have identified knockoff products sold by others we believe may infringe upon our intellectual property rights. Knockoff products often are sold under a brand name that is the same as or substantially similar to the HEELYS name. Knockoff and counterfeit products may continue to emerge, as others seek to trade on the goodwill of the HEELYS name and benefit from consumer demand for our products. We may not be able to detect all knockoff and counterfeit products and may lose our competitive position in a given geographic market before we become aware of any such infringement.

To protect our HEELYS brand, we have already spent significant resources and may be required to spend significantly greater resources in the future to monitor and police our intellectual property rights. If we are unsuccessful in enforcing our intellectual property rights, sales of counterfeit, knockoff or infringing products by others could harm our HEELYS brand and adversely affect our business, financial condition and results of operations. Even if we successfully enforce our intellectual property rights, the presence in the market of counterfeit, knockoff or infringing products of poor quality for even a short time period could have a detrimental impact on our HEELYS brand.

We may not be able to obtain and maintain patent, trademark or other intellectual property rights protection in some foreign countries, which could result in our being unable to prevent others from using our HEELYS mark and product, which could have a material adverse effect on our business.

We depend upon the laws of the countries where our products are sold to protect our intellectual property. Intellectual property rights may be unavailable or limited in some countries because patent laws and standards of patentability vary internationally. Consequently, in certain foreign jurisdictions, we have elected not to apply for patents or trademark registrations. Further, patent and trademark protection may not be available for the HEELYS mark and product in every country where our products are sold. While we generally apply for patents and trademarks in most countries where we intend to sell patented products, we may not accurately predict all of the countries where patent or trademark protection will ultimately be desirable. If we fail to timely file a patent or trademark application in any such country, we will likely be precluded from doing so at a later date. Failure to adequately pursue and enforce our patent and trademark rights could damage our HEELYS brand, enable others to compete with us and impair our ability to compete effectively.

In some countries where we have sought patent protection, third parties have challenged the validity, enforceability and scope of our patent rights. Patent laws, and standards of patentability and validity, vary from one country to the next. Patent validity challenges are commonly filed as counterclaims in patent litigation proceedings. There can be no assurance that we will prevail against any challenges. Our HEELYS brand, business, financial condition and results of operations could be adversely affected if we fail to obtain and maintain intellectual property right protection in foreign countries where we derive a large amount of our net sales.

A downturn in the economy and adverse trends in retailing could have a material adverse effect on our results of operations.

In the current economic environment, consumer confidence is low resulting in a reduction in discretionary consumer spending. When discretionary consumer spending is reduced, purchases of our products may decline. We have noticed caution from our retail customers and this may continue to result in lower than expected orders by some of our customers. Continued uncertainties regarding future economic prospects could have a material adverse effect on our results of operations. An economic slowdown in any of our major markets could adversely affect the demand for our products and pressure our gross margins due to, among other potential factors, higher promotional spending, recessionary economic cycles, higher interest borrowing rates, higher fuel and other energy costs, inflation, increases in commodity prices, higher levels of unemployment, higher consumer debt levels, higher tax rates and other changes in tax laws or other economic factors that may affect consumer spending or buying habits. Reduced sales by some of our retail customers or independent distributors, along with the possibility of their reduced access to, or inability to access, the credit markets, may result in various retailers or independent distributors experiencing significant financial difficulties. Financial difficulties of retail customers could result in reduced sales to those customers or could result in store closures, bankruptcies or liquidations. Higher credit risk relating to receivables from retail customers experiencing financial difficulty may result. An economic downturn in any of our major markets or continued uncertainties regarding future economic prospects could have a material adverse effect on our results of operations.

Particularly in Europe, the current sovereign debt crisis affecting Greece, Ireland, Italy, Portugal and Spain, and related European financial restructuring efforts, may cause the value of the European currencies, including the Euro, to further deteriorate, which in turn could adversely impact our Euro-denominated sales and working capital. In addition, the European crisis may contribute to instability in global credit markets, and further economic deterioration in Europe could adversely impact demand for our products and product pricing.

Because we are a consumer products company, if we fail to accurately forecast consumer demand and trends in consumer preferences, our HEELYS brand, net sales, customer relationships and results of operations may be adversely affected.

Demand for our products, and for consumer products in general, is subject to rapidly changing consumer demand and trends in consumer preferences. Therefore, our success depends upon our ability to:

- identify, anticipate, understand and respond to these trends in a timely manner;
- design our HEELYS-wheeled footwear to appeal to a wider range of consumers; and
- introduce appealing new products and performance features on a timely basis.

We generally must make decisions regarding product designs several months before our products are available for sale, and it can take us up to six months to achieve full production of certain models. Accordingly, at the time we have to make decisions that determine our inventory levels, we cannot be certain that our product offerings will be well received by consumers, in which case we may be forced to liquidate excess inventories at a discount. In addition to offering our standard styles, we may collaborate with certain of our retail customers to develop HEELYS-wheeled footwear styles that these retail customers have the exclusive rights to sell. If these retail customers are unable to sell through these footwear styles we may agree to provide marketing discretionary fund assistance or to accept return of this inventory. Because these styles have been specifically designed for a particular customer, we may not be able to sell the returned inventory or may not be able to sell the returned inventory at or above cost. Conversely, if we underestimate consumer demand for our products, we could have inventory shortages, which would result in lost sales, delays in shipments to retail customers and independent distributors, strains on our relationships with retail customers and independent distributors and diminished brand loyalty. Even if we introduce appealing new styles and products on a timely basis, we may set prices for our products too high to be successful. A decline in demand for our products, or any failure on our part to satisfy increased demand for our products, could adversely affect our net sales and results of operations.

Our operations are dependent upon the strength of our relationships with our retail customers and independent distributors and their success in selling our products, and a small number of retail customers and independent distributors are responsible for a significant percentage of our net sales.

Our success is dependent upon the willingness and ability of our retail customers to market and sell our products to consumers, as well as the success of our independent distributors in developing foreign markets for our products. For the years ended December 31, 2011 and December 31, 2010, Oxylane Group accounted for approximately 11.7% and 11.9% of our consolidated net sales, respectively. Oxylane Group is a French sporting goods retail chain operating under the name Decathlon. For the year ended December 31, 2010, Privee AG Corporation (formerly AG Corporation) accounted for approximately 17.7% our consolidated net sales. Privee AG Corporation was the Company's independent distributor in Japan. No other retail customer or independent distributor accounted for 10% or more of our consolidated net sales in either of these periods. If any of these, or our other significant retail customers or independent distributors, were to experience financial difficulties, reduce the quantity of our products it sells, discount the retail sales price, request markdown assistance or additional marketing assistance, or stop selling our products, our financial condition and results of operations could be adversely affected.

On November 25, 2010, we notified Privee AG Corporation we would not be renewing our distributor agreement with Privee AG Corporation, which terminated on February 28, 2011. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011.

We do not have long-term contracts with any of our retail customers or independent distributors, and the loss or material reduction in their business with us could result in reduced sales of our products.

Our retail customers and independent distributors generally purchase products from us on a purchase order basis and do not have long-term contracts with us. Consequently, with little or no notice and without penalty, our retail customers and independent distributors may terminate their relationship with us or materially reduce the level of their purchases of our products. For example, in 2007 one of our then large retail customers determined that it would no longer sell HEELYS-wheeled footwear. This customer accounted for 7.2% of our total net sales for the year ended December 31, 2007. If this were to occur with more retail customers or independent distributors who purchase significant quantities of our products, it may be difficult for us to establish substitute relationships in a timely manner, which could have a material adverse effect on our financial condition and results of operations.

Changes in the manner in which, or mix of retail customers to whom, we distribute our products could impact our gross margin and brand image, which could have a material adverse effect on our results of operations.

We sell our products through a mix of retail customers. Our Sidewalk Sports™ brand utilizes lower-cost materials and basic designs and sells for less than our other wheeled products. This brand will be sold domestically and in certain international markets. Depending on the reaction to the brand, we may experience a change in the mix of our retail customers. Any material changes in the distribution to, or mix of, our retail customers could adversely affect our gross margin, and these changes, as well as the introduction of the Sidewalk Sports™ brand to our line of products, may negatively affect both our brand image and our reputation with our consumers. A negative change in our gross margin or our brand image and acceptance could have a material adverse effect on our results of operations and financial condition. Our sales of products directly to consumers via our website, which we began in the second quarter of 2010, and the introduction of our Sidewalk Sports™ brand, may alienate certain of our retail customers and result in reduced sales to these customers. Reduced sales to our retail customers could have an adverse impact on our financial condition and results of operations.

We may be adversely affected by the financial condition of our retailer customers.

Some of our retail customers have experienced financial difficulties in the past. A retail customer experiencing such difficulties will generally not purchase and sell as many of our products as it would under normal circumstances and may cancel orders. In addition, a retail customer experiencing financial difficulties generally increases our exposure to the risk of uncollectible receivables. We extend credit to our retail customers based on our assessment of such customer's financial condition, generally without requiring collateral. While such credit losses have historically been within our expectations and reserves, we cannot assure you that this will continue. Financial difficulties on the part of our retail customers could have a material adverse effect on our results of operations and financial condition.

Because we outsource all of our manufacturing to a limited number of independent manufacturers, we may face challenges in maintaining a sufficient supply of products to meet demand for our products or experience interruptions in our supply chain. Any shortfall in the supply of our products may decrease our net sales and have an adverse impact on our customer relationships and results of operations

All of our products are produced by independent manufacturers with which we do not have long-term contracts. As such, any of our manufacturers could unilaterally terminate its relationship with us or increase the prices it charges us at any time. A limited number of independent manufacturers produce all of our HEELYS-wheeled footwear. Consequently, if any such manufacturers close, stop producing merchandise for us or greatly increase prices, these actions could result in delayed deliveries to our retail customers, could adversely affect our revenue and results of operations, and could require the establishment of new manufacturing relationships, which could require significant additional time and expense.

Our business could suffer if our independent manufacturers violate legal requirements or fail to conform to generally accepted ethical standards.

We expect our independent manufacturers to comply with applicable legal requirements and generally accepted ethical standards for working conditions and other matters. However, we do not control our independent manufacturers or their business practices. If any of our manufacturers were to use forced or indentured labor or child labor, fail to pay compensation in accordance with local law, fail to operate in compliance with local safety regulations or diverge from other applicable legal requirements or business practices generally accepted as ethical, we would take appropriate action, which could result in an interruption in our product supply. In addition, we could suffer negative publicity and damage to our reputation and the value of our HEELYS brand, which would adversely affect our business and results of operations.

If our independent manufacturers are unable to obtain raw materials, our costs could increase or the delivery of our products could be delayed, which could adversely affect our net sales and results of operations.

The production capacity of our independent manufacturers is dependent, in part, upon the availability of raw materials. Our manufacturers may experience shortages of raw materials, which could result in increased costs to us or delays in deliveries of our products from our manufacturers. As a result, we could experience cancellation of orders, refusal to accept deliveries or a reduction in our sales prices and profit margins, any of which could harm our net sales and results of operations.

Our distribution efforts internationally, including our recent efficiency and cost reduction initiative with respect to our Belgian office, involve inherent risks which could result in harm to our business.

During 2008, we opened an office in Brussels, Belgium, with branch offices in Germany and France, to focus on expanding our international opportunities by working more closely with our distributors, establishing relationships with distributors in new international markets and, in select markets, selling our products direct to retail customers. As part of an initiative to improve efficiency and reduce costs, we began taking steps in the first quarter of 2012 to close our office in Brussels and transition our business operations conducted through that office to our French and German offices. We cannot assure you that we will be able to implement this initiative successfully, and we anticipate incurring additional expenses, some of which may be material in the period in which those expenses are incurred. Even if we are successful with this initiative, we may not be able to translate all of the cost savings from this initiative into increased earnings and may face other risks associated with the initiative, including, among other things, declines in employee morale and interruptions in our European business operations. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011.

Our ability to meet customer expectations, manage inventory, complete sales and achieve objectives for operating efficiencies depends upon the proper operation of our distribution model (taking into account the absorption by our French and German offices of business operations conducted through our Belgian office) and the development of additional distribution capabilities. This distribution model is subject to a number of risks,

Fluctuations in foreign currency exchange rates could harm our results of operations.

We pay for our products, and our independent distributors pay us, in U.S. dollars. International sales accounted for approximately 62.8% and 71.6% of our consolidated net sales in 2011 and 2010, respectively. If the U.S. dollar strengthens compared to the currency in the foreign markets where our products are sold, our products will be more expensive in those markets, making them less attractive to consumers. If the U.S. dollar significantly weakens compared to the currency in the foreign markets where our products are produced, our manufacturers could increase the prices they charge us for our products, which could reduce our profitability. There can be no assurance that we can effectively mitigate our foreign exchange risk.

We are exposed to gains and losses resulting from the effect that fluctuations in foreign currency exchange rates have on the reported results in our consolidated financial statements due to the translation of the statement of operations and balance sheet of our Belgian subsidiary into U.S. dollars. For example, there is currently an intercompany loan due to our U.S. entity from our Belgian subsidiary which must be repaid in U.S. dollars. Because this intercompany loan is U.S. dollar denominated (and not Euro denominated, which is the functional currency of our Belgian subsidiary), our Belgian subsidiary recognizes a loss if the U.S. dollar strengthens compared to the Euro and recognizes a gain if the U.S. dollar weakens compared to the Euro. This impact is recorded in other income and expense.

In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011. We are exposed to similar gains and losses, as with our Belgian subsidiary, resulting from the effect of fluctuations in the foreign currency exchange rate between the U.S. dollar (our reporting currency) and the Japanese Yen (the functional currency of our Japanese subsidiary). Similar to our Belgian subsidiary, there is an intercompany loan due to our U.S. entity from our Japanese subsidiary. This intercompany loan is denominated in U.S. dollars as opposed to the Japanese Yen. If the U.S. dollar strengthens against the Yen, a loss would be recognized, but if the U.S. dollar weakens against the Yen, a gain would be recognized. This impact would be recorded in other income and expense.

We translate the revenues and expenses of our foreign subsidiaries at the average rate of exchange during the applicable period. As a result, the reported revenues and expenses of our Belgian and Japanese subsidiaries would decrease if the U.S. dollar increased in value in relation to the Euro and Yen.

We have not used foreign currency exchange contracts to hedge the profit and loss effects of any foreign currency exchange translation effect.

We are dependent on our management and other personnel, and the failure to attract and retain such individuals could adversely affect our operations.

Our success depends on our ability to attract and retain qualified managerial and other personnel. Our management and other employees can terminate their employment with us at any time, and we do not maintain key person life insurance. Our inability to attract or retain qualified employees, or the loss of any key employee, could harm our business and results of operations.

Since early 2008, we have had significant turnover in our executive officers. In February 2008, Michael G. Staffaroni, our Chief Executive Officer since 2001, and Charles D. Beery, our Senior Vice President—Global Sales since 2001, resigned. In April 2008, Patrick F. Hamner, our Senior Vice President, resigned and entered into a consulting agreement with us which terminated in June 2010. In May 2008, Michael W. Hessong, our Chief Financial Officer resigned and our Board of Directors elected Donald K. Carroll as our Chief Executive Officer. In February 2009, Mr. Carroll resigned as Chief Executive Officer and Mr. Hessong returned as our interim Chief Executive Officer. In July 2009, our Board of Directors elected Thomas C. Hansen to serve as our Chief Executive Officer. In June 2010, Lisa K. Peterson, our Chief Financial Officer resigned and our Board of Directors appointed Craig D. Storey as our Chief Financial Officer.

We rely on our independent sales representatives, and if our relationship with our representatives was terminated, it could result in reduced sales of our products.

Historically, we sold substantially all of our products domestically through a national sales force of independent sales representatives who were employed by independent sales agencies. Since 2011, our domestic retail accounts have been served by a national sales force of sales representatives employed by a single independent sales agency. In our German and French markets, as well was in Italy, Spain and Portugal, where we sell directly to retailers, we sell our products through independent sales representatives. In our Japanese market, where we began to sell directly to retailers effective March 1, 2011, we sell our products through employed sales staff. We rely on independent sales representatives to provide new customer prospects and market our products to our retail customers. Our independent sales representatives generally do not sell our products exclusively and may terminate their relationships with us at any time with limited notice. Our ability to maintain and increase our sales depends in large part on our success in maintaining relationships with our independent sales representatives on commercially reasonable terms. Any failure to maintain and develop new satisfactory relationships with independent sales representatives, or any failure of our independent sales representatives to effectively market our products, could adversely affect our sales.

Negative publicity relating to our products could cause our HEELYS brand to suffer and adversely affect our net sales and results of operations.

Various media outlets have reported on injuries suffered by users of our products and have quoted from or referred to medical studies and U.S. Consumer Product Safety Commission data relating to injury rates of users of wheeled footwear. This negative publicity, and any future negative publicity, relating to the safety of our products or products similar to ours could cause our HEELYS brand image to suffer and adversely affect our net sales and operating performance.

Additional bans on the use of our HEELYS-wheeled footwear due to public safety and liability concerns could adversely affect our net sales and results of operations.

Various places of business and other institutions, such as shopping malls and schools, have imposed bans on the use of our HEELYS-wheeled footwear due to public safety and liability concerns. If the number of businesses and other institutions imposing such bans increases in the future, consumers could find our HEELYS-wheeled footwear less appealing, which could adversely affect our net sales and results of operations.

If our products fail to comply with U.S. consumer product laws, it could materially affect our gross margin and results of operations.

With the passage of the Consumer Product Safety Improvement Act of 2008, or "CPSIA," there are new requirements mandated for the textiles and apparel industries. These mandates relate to all products marketed to children 12 years of age and under. Among other requirements, the Consumer Product Safety Commission, or "CPSC," requires a certification and testing of lead paint levels as applied to certain products, along with testing the lead content of the product as a whole. We work with an accredited third party testing service to ensure compliance with all CPSIA requirements and to further product safety goals. We will continue to monitor the situation and intend to abide by all rules and changes made by the CPSC. This could have a negative impact on the cost of our goods and poses a potential risk if we do not adhere to these requirements.

We are subject to product liability, warranty and recall claims and our insurance coverage may not cover such claims, which could cause us to incur substantial costs and adversely affect our business.

Due to the inherent risk of injury related to the use of our products, our business exposes us to claims for product liability and warranty claims if our products actually or allegedly fail to perform as expected, or the use of our products results or is alleged to result in personal injury, disability or death. There can be no assurance we will be able to successfully defend or settle the product liability claims and lawsuits to which we are, and in the future may be, subject.

We attach warning labels to our products and packaging relating to safe usage and the risk of injury. However, if a product liability claim is brought against us, the content of the warnings, the placement of them, or both, may be considered inadequate by courts, exposing us to liability. We cannot be certain that our safety warning labels are adequate. Product liability claims could result in us having to expend significant time and expense to defend these claims and to pay, if necessary, settlement amounts or damages, which could adversely affect our financial condition. In addition, claims that use of our products resulted in an injury, disability or death could cause our HEELYS brand image and operating performance to suffer by damaging our reputation and prospects and by diverting the time and attention of our management, even if we are not at fault.

There can be no assurance our product liability insurance coverage will be adequate, that our insurers will be financially viable when payment of a claim is required or that we will be able to obtain such insurance in the future on acceptable terms, if at all.

If any of our products are or are alleged to be defective, we may be required to recall that product. Any product recall could cause us to incur substantial cost, and irreparably harm our relationships with our customers and our brand image, which could adversely affect our business.

If our new products are not accepted by our customers or we are unable to maintain our margins, it could materially affect our financial performance.

As is typical with new products, market acceptance of our new products is uncertain and achieving market acceptance may require substantial marketing efforts and expenditures. We also cannot assure that our new products will have the same or better margins than our current products. The failure of the new products to gain market acceptance, or our inability to maintain our current product margins with the new products, could adversely affect our business, financial performance and brand image.

We may not be able to compete effectively, which could have a negative impact on our sales and our business.

We compete with companies that sell to young consumers in several different product markets, including footwear, sporting goods and recreational products. These markets are intensely competitive and we expect competition to increase in the future. A number of our competitors have significantly greater financial, marketing, distribution and manufacturing resources than we do, as well as greater brand awareness in the markets in which they operate. We also compete with counterfeit, knockoff and infringing products, which are often sold at lower prices. If we fail to remain competitive with respect to the quality, design, price and timely delivery of products, our business, financial condition and results of operations could be materially adversely affected.

Third parties may claim that we are infringing their intellectual property rights, and such claims may be costly to defend, may require us to pay licensing fees, damages or other amounts and may prevent or limit the manufacture, marketing or sale of our products.

Third parties may successfully claim we are infringing their intellectual property rights. While we do not believe any of our products infringe the valid intellectual property rights of third parties, we may be unaware of the intellectual property rights of others that may cover some of our technology or products. For example, because many patent applications in the United States are not publicly disclosed immediately after they are filed, we could adopt technology without knowledge of a pending patent application, which technology would infringe a third-party patent once that patent is issued.

Our competitors in both the United States and foreign countries may have applied for or obtained, or may in the future apply for or obtain, patents that will prevent, limit or otherwise interfere with our ability to make, market or sell our products. Although we may conduct our own independent review of patents issued to certain third parties, we cannot assure you we will be aware of all pre-existing technology that may subject us to patent litigation. Further, we may adopt a trademark or trade dress that a third party claims infringes their rights in

such trademark or trade dress. If we are forced to defend against infringement claims, whether or not such claims are resolved in our favor, we could encounter expensive and time-consuming litigation which could divert the attention of our management and other key personnel from our business operations. Furthermore, if we are found to be infringing intellectual property rights of others, we could be required to pay licensing fees or damages. In addition, if we are not able to obtain license agreements on terms acceptable to us, or at all, we may be prevented from manufacturing, marketing or selling our products. As a result, our net sales could be significantly reduced and our cost of sales could be significantly increased, either of which could have an adverse effect on our business.

HEELYS-wheeled footwear could become subject to import duties in the United States and Japan, and if we cannot increase our prices to compensate for such duties, it could reduce our profitability.

HEELYS-wheeled footwear is currently classified by U.S. Customs and Border Protection and Japan Customs such that we do not pay import duties to the United States or Japan. These customs classifications can be changed at any time, and although we would vigorously oppose any proposed change, there can be no assurance that we would prevail. If the classification for HEELYS-wheeled footwear changed and HEELYS-wheeled footwear became subject to an import duty, it might be difficult to increase our prices to compensate for any such duty, which could reduce our profitability.

Expanding our distribution to mass merchants could have a material adverse effect on brand image and results of operations.

We primarily sell our products to sporting goods retailers, specialty apparel and footwear retailers, and family footwear stores in an effort to maintain a high-quality image for our HEELYS brand and targeted price points for our products. During the fourth quarter 2011 (Holiday season), the two-wheel version of our new brand, Sidewalk Sports™, was available exclusively in Kmart stores; and, if necessary we may sell certain styles of our product to discount retailers in order to sell excess inventory. Expanded sales of Sidewalk Sports™ or other related brands to mass merchants in the future could negatively affect our HEELYS brand image and our reputation with consumers, which could adversely affect our results of operations and financial condition.

Our operating results are subject to seasonal and quarterly variations in our net sales and net income, which could adversely affect the price of our common stock.

We have experienced, and expect to continue to experience, substantial seasonal and quarterly variations in our net sales and net income. Our quarterly results of operations may also fluctuate significantly as a result of a variety of other factors, including, among other things, the amount of inventory carried by our retailers, timing of holidays and advertising initiatives and changes in our product mix. In addition, variations in weather conditions may significantly affect our results of operations.

As a result of these seasonal and quarterly fluctuations, we believe comparisons of our operating results between different quarters within a single year are not necessarily meaningful and that these comparisons cannot be relied upon as indicators of our future performance. Any seasonal or quarterly fluctuations that we report in the future may differ from the expectations of market analysts and investors. This could cause the price of our common stock to fluctuate significantly.

Improvements to our information technology systems may be inadequate, which could adversely affect our ability to operate effectively.

As our business needs change, we could experience difficulties associated with our information technology systems. If we experience difficulties in our information technology systems or experience system failures, or if we are unable to successfully modify our information technology systems to respond to changes in our business or operating model, our ability to operate effectively and our internal controls could be adversely affected.

Disruptions to our information technology systems could adversely affect our ability to operate effectively.

During 2011, we migrated our information technology systems, located in our Texas headquarters, from Microsoft Solomon to Microsoft Navision. Our European operations are currently, and our operations in Japan will also be, operating on the Microsoft Navision platform. We are a highly automated business and disruption in, or failure of, our information technology systems could cause delays in completing sales. If we experience difficulties or disruptions in our information technology systems or experience system failures, for any reason, including acts of God, terrorism, or if we are unable to successfully modify or upgrade our information technology systems to respond to changes in our business, our ability to operate effectively and our internal controls could be adversely affected.

We may have difficulty identifying and successfully integrating acquisitions into our business and any acquisitions we make could result in adverse consequences.

As part of our business strategy we may make acquisitions. The pursuit of acquisitions may divert the attention of management and cause us to incur significant expenses identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated.

We have limited experience acquiring other businesses and may not be able to successfully integrate any acquired operations with our business or effectively manage the combined business following an acquisition. We also may not achieve the anticipated benefits of an acquisition due to any of the following factors:

- unanticipated costs associated with making the acquisition and operating the acquired business;
- harm to our business relationships with independent manufacturers, retail customers and independent distributors;
- loss of key employees of the acquired business; or
- difficulties associated with entering product categories or markets in which we have little or no prior experience.

If we experience any of the difficulties noted above, our business and financial condition could be adversely affected.

We have experienced volatility in our stock price and may fluctuate in the future. Therefore, you may be unable to resell shares of our common stock at or above the price you paid for them.

The market price of our common stock has fluctuated significantly in the past and may fluctuate significantly in the future. Volatility in the trading price of our common stock may prevent you from being able to sell your shares of our common stock at prices equal to or greater than your purchase price. Such fluctuations may be influenced by many factors, many of which are outside of our control, including:

- our operating and financial performance and prospects;
- our quarterly or annual earnings or those of other companies in our industry;
- the public's reaction to our press releases, other public announcements and filings with the SEC;
- changes in earnings estimates or recommendations by research analysts who track our common stock or the stock of other companies in our industry;
- strategic actions by us or our competitors;

- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles;
- changes in general economic conditions in the United States and global economies or financial markets, including such changes resulting from war or acts of terrorism; and
- sales of our common stock.

In addition, in recent years the stock market has experienced significant price and volume fluctuations. This volatility has had a significant impact on the trading price of securities issued by many companies, including companies in our industry. The changes frequently occur irrespective of the operating performance of the affected companies. Hence, the trading price of our common stock could fluctuate based upon factors that have little or nothing to do with our business.

Existing stockholders significantly influence our corporate governance.

As of December 31, 2011, our executive officers, key employees, directors and their affiliates beneficially owned, in the aggregate, approximately 35% of our outstanding common stock. In addition, Capital Southwest Venture Corporation, or "CSVC," which owns approximately 33.8% of our common stock, has the contractual right to designate (i) two nominees for director to be included in management's slate of director nominees, so long as it owns at least 15% of the outstanding shares of our common stock, and (ii) one such nominee so long as it owns at least 10%, but less than 15%, of the outstanding shares of our common stock. CSVC's parent company is Capital Southwest Corporation ("CSC"). The Chairman of our Board of Directors is the President and CEO of CSC. In addition, one of our directors is a Vice President of CSC. As a result, through its designees, CSVC may significantly influence our corporate governance.

Our Certificate of Incorporation, By-Laws and Delaware law contain provisions that could discourage a third party from acquiring us and consequently decrease the value of an investment in our common stock.

Our Certificate of Incorporation, By-Laws and Delaware corporate law contain provisions that could delay or prevent a change in control of our company or changes in our management. Among other things, these provisions:

- authorize our board of directors, without prior stockholder approval, to issue preferred stock with rights, privileges and preferences, including voting rights, senior to those of our common stock;
- prohibit stockholder action by written consent, thereby requiring all stockholder actions to be taken at a meeting of our stockholders;
- establish advance notice requirements for submitting nominations for election to the board of directors and for proposing matters that can be acted upon by stockholders at a meeting; and
- impose restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock.

These provisions could discourage proxy contests, make it more difficult for our stockholders to elect directors and take other corporate actions and may discourage, delay or prevent a change in control or changes in our management that a stockholder might consider favorable. Any delay or prevention of a change in control or change in management that stockholders might otherwise consider to be favorable could deprive you of the opportunity to sell your common stock at a price in excess of the prevailing trading price and cause the trading price of our common stock to decline.

As a public company, we are required to meet periodic reporting requirements under SEC rules and regulations. Complying with federal securities laws as a public company is expensive. Any deficiencies in our financial reporting or internal controls could adversely affect our business and the trading price of our common stock.

SEC rules require, as a publicly traded company, that we file periodic reports containing our financial statements within a specified time following the completion of quarterly and annual periods. We may experience difficulty in meeting the SEC's reporting requirements. Any failure by us to file our periodic reports with the SEC in a timely manner could harm our reputation and reduce the trading price of our common stock and cause sanctions or other actions to be taken by the SEC. As a public company, we incur significant legal, accounting, insurance and other expenses.

We may identify deficiencies which would have to be remediated to satisfy the SEC rules for certification of our internal control over financial reporting. As a consequence, we may have to disclose in periodic reports we file with the SEC material weaknesses in our system of internal controls. The existence of a material weakness would preclude management from concluding that our internal control over financial reporting is effective. In addition, disclosures of this type in our SEC reports could cause investors to lose confidence in our financial reporting and may negatively affect the trading price of our common stock. Moreover, effective internal controls are necessary to produce reliable financial reports and to prevent fraud. If we have deficiencies in our disclosure controls and procedures or internal control over financial reporting it may negatively impact our business, results of operations and reputation.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We lease our corporate headquarters, an approximately 48,400 square-foot facility located in Carrollton, Texas, consisting of approximately 34,500 square feet of warehouse space and approximately 13,900 square feet of office space. Our lease expires in August 2015, but we have two five-year extension options.

On May 1, 2008 our Belgian subsidiary entered into an operating lease for office space in Brussels, Belgium for nine years with the option to terminate the lease at the end of each three-year period. This lease was not terminated at the end of the first three year period. While we have begun taking steps in the first quarter of 2012 to close our Belgian office, and transition our business operations conducted through that office to our French and German offices, we have not terminated our operating lease for our Belgian office.

On April 1, 2008 our Belgian subsidiary entered into an operating lease for office space in Munich, Germany for three years with an automatic renewal at the end of the initial three year lease, unless six months notice is provided. This lease was renewed for a period of one year from April 1, 2011 through March 31, 2012 and has been renewed for a period of one year from April 1, 2012 through March 31, 2013.

On May 1, 2008 our Belgian subsidiary entered into an operating lease for office space in Annecy, France for nine years with the option to terminate the lease at the end of each three year period. This lease was not terminated at the end of the first three year period.

On March 1, 2011, our Japanese subsidiary entered into an operating lease for office space in Tokyo, Japan for two years with an automatic renewal at the end of the initial two year lease, unless six months notice is provided.

We believe our existing facilities are adequate to meet our current requirements.

Item 3. Legal Proceedings

Due to the nature of the Company's products, from time to time the Company has to defend against personal injury and product liability claims arising out of personal injuries that allegedly are suffered using the Company's products. To date, none of these claims has had a material adverse effect on the Company. The Company is also engaged in various claims and legal proceedings relating to intellectual property matters, especially in connection with enforcing the Company's intellectual property rights against the various third parties importing and selling knockoff products domestically and internationally. Often, such legal proceedings result in counterclaims against the Company that the Company must defend. The Company believes none of the pending personal injury, product liability or intellectual property legal matters will have a material adverse effect on the Company's financial position, cash flows or results of operations.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Our common stock is listed on The Nasdaq Capital Market under the stock symbol "HLYS." As of March 13, 2012, there were approximately 126 holders of record of our common stock. The following table sets forth the range of high and low market prices for the common stock during the years ended December 31, 2011 and 2010.

2011	High	Low
First Quarter	$ 3.39	$ 2.03
Second Quarter	$ 2.37	$ 1.90
Third Quarter	$ 2.43	$ 1.86
Fourth Quarter	$ 2.15	$ 1.75

2010	High	Low
First Quarter	$ 2.55	$ 2.08
Second Quarter	$ 2.97	$ 2.31
Third Quarter	$ 3.75	$ 2.14
Fourth Quarter	$ 3.63	$ 2.37

Dividends

Other than a special cash dividend paid on December 22, 2008, we have not paid any dividends. Any future determination relating to dividend policy will be made at the discretion of our board of directors and will depend on a number of factors, including our outstanding indebtedness, earnings, capital requirements, financial condition and future prospects, applicable Delaware law, which provides that dividends are only payable out of surplus or net profit for the then current and immediately preceding fiscal years, and other factors that our board of directors may deem relevant. Future agreements governing our borrowings, and the terms of any preferred stock we may issue in the future, will also likely contain restrictive covenants prohibiting us from paying dividends.

Initial Public Offering of Our Common Stock and Use of Proceeds

On December 13, 2006, we completed the initial public offering of our common stock pursuant to a Registration Statement (File No. 333-137046) that was

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	2,072,002[1]	$ 3.71[2]	358,546
Equity compensation plans not approved by security holders	—	$ —	—
Total	2,072,002	$ 3.71	358,546

(1) Includes up to 63,559 shares issuable on vesting of outstanding restricted stock units at the end of the performance period May 1, 2010 to December 31, 2012, if the maximum performance goal for the performance year January 1, 2012 to December 31, 2012 is achieved. Includes up to 489,726 shares issuable on vesting of outstanding restricted stock units, at the end of the performance period January 1, 2011 to December 31, 2013, if the maximum performance goals for the performance years January 1, 2012 to December 31, 2012 and January 1, 2013 to December 31, 2013 are achieved.

(2) Calculation of weighted-average exercise price does not include restricted stock units because they have no exercise price.

Exercise of Registration Rights

As previously disclosed in our Annual Reports on Form 10-K and our Registration Statement on Form S-1 filed with the SEC on September 1, 2006, the Company is party to a Registration Rights Agreement, dated May 26, 2000 (the "Registration Rights Agreement"), by and among the Company, Patricia and Samuel Ligon, and Capital Southwest Venture Corporation ("CSVC"). The Registration Rights Agreement is attached as Exhibit 10.1 to our Registration Statement on Form S-1 filed on September 1, 2006.

Pursuant to its rights under Section 2(a) of the Registration Rights Agreement, CSVC has notified the Company of its election to exercise its registration rights with respect to all of the Company's Registrable Securities (as defined in the Registration Rights Agreement) held by CSVC and CSVC has requested that the Company file a registration statement on Form S-3 (the "Registration Statement") with respect to the Registrable Securities promptly after the Company files this Annual Report on Form 10-K with the SEC. The Company intends to comply with its obligations under the Registration Rights Agreement and file the Registration Statement promptly after the Company files this Annual Report on Form 10-K with the SEC.

The Company will not receive any of the proceeds from any resale of the Company's common stock by CVSC.

The foregoing disclosure shall not constitute an offer to sell or the solicitation of an offer to buy any securities, nor shall it constitute an offer, solicitation or sale in any jurisdiction in which such offer, solicitation or sale is unlawful.

Item 6. Selected Financial Data

We are a Smaller Reporting Company as defined in Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide information under this Item.

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

The following discussion should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements due to known and unknown risks, uncertainties and other factors, including those described in Part I, "Item 1A. Risk Factors" and elsewhere in this Annual Report on Form 10-K. Those risk factors expressly qualify all subsequent oral and written forward-looking statements attributable to us or persons acting on our behalf. We disclaim any intention or obligation to update or review any forward-looking statements or information, whether as a result of new information, future events or otherwise.

Throughout this report, references to the "Company," "we," and "our" refer to Heelys, Inc. and its consolidated subsidiaries, unless the context indicates otherwise.

Overview

We are a designer, marketer and distributor of innovative, action sports-inspired products primarily under the HEELYS brand targeted to the youth market. Our primary product, HEELYS-wheeled footwear, is patented, dual-purpose footwear that incorporates a stealth, removable wheel in the heel. HEELYS-wheeled footwear allows the user to seamlessly transition from walking or running to rolling by shifting weight to the heel. Users can transform HEELYS-wheeled footwear into street footwear by removing the wheel. In 2011, approximately 98% of our net sales was derived from the sale of our HEELYS-wheeled footwear. The remainder of our net sales was derived from the sale of our Nano™ inline footboard and branded accessories, such as replacement wheels, and from the distribution of third-party brands in Europe.

We introduced HEELYS-wheeled footwear in 2000, and for several years our domestic sales were concentrated with one large, national specialty retailer. Although we initially focused on driving our domestic sales growth, we also established relationships with independent distributors in Japan, South Korea and Southeast Asia. As a result, the sources of our net sales were largely concentrated and we were susceptible to customer-specific and region-specific factors. This concentration caused variability in our results of operations. Since that time, we have diversified our retail customer base in the United States by widening our distribution to include full-line sporting goods retailers, specialty apparel and footwear retailers, family footwear stores and select online retailers. We have also expanded our international distribution channels to mitigate this concentration. Historically, our products have been sold to independent distributors with exclusive rights to specified international markets. In 2008, we formed a Belgian subsidiary, with an office in Brussels and branch offices in Germany and France, and expanded our international opportunities by working more closely with our distributors, establishing relationships with distributors in new international markets and, in select markets, selling our products direct to retail customers. Effective March 31, 2008 and April 30, 2008, respectively, we entered into agreements with our former distributor in Germany and Austria (German market) and our former distributor in France, Monaco and Andorra (French market) whereby we terminated their rights to distribute our products in their specified markets. Our Belgian subsidiary took over the distribution of our products in the German market effective April 1, 2008 and in the French market effective May 1, 2008. As part of an initiative to improve efficiency and reduce costs, we began taking steps in the first quarter of 2012 to close our office in Brussels and transition our business operations conducted through that office to our French and German offices. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011.

Continued growth of our net sales will depend on consumer demand for HEELYS-wheeled footwear and our ability to satisfy this demand. A number of factors may impact consumer demand for our products, including:

- general economic conditions, particularly changes in consumer discretionary spending patterns;
- the effectiveness of our marketing strategies;
- our ability to effectively distribute our products;
- our ability to design products that appeal to our target consumers;
- our ability to protect our intellectual property rights; and
- changes in the popularity of and participation in wheeled sports activities.

We intend to continue to diversify our product offering with new HEELYS-wheeled footwear models in order to benefit from the recognition of our HEELYS brand. Designing, marketing and distributing new products will require us to devote additional resources to product development, marketing and operations. These additional resources may include hiring new employees to support expansion in these areas and increasing amounts allocated to product advertising and promotion. Each of these additional resource commitments will increase our selling, general and administrative expenses. Because the selling price and unit cost of new products may differ from those of our existing products, sales of these new products may also impact our gross margin. In addition, we may seek to selectively acquire new products and companies.

General

Net Sales

Net sales represent primarily sales of HEELYS-wheeled footwear, less an estimated reserve for sales returns, allowances (including certain allowances for marketing, promotion and advertising support) and discounts. Amounts billed to customers for shipping and handling are included in net sales.

We sell our products through distribution channels that generally merchandise our products in a manner that we believe enhances and protects our HEELYS brand image.

Domestically, our products can be found in full-line sporting goods retailers, specialty apparel and footwear retailers, family footwear stores and select online retailers. For 2011, 37.2% of our net sales were derived from domestic retail customers.

Internationally, our products historically have been sold primarily to independent distributors with exclusive rights to specified markets. During 2008, we formed a Belgian subsidiary, with an office in Brussels and branch offices in Germany and France, and expanded our international opportunities by working more closely with our distributors, establishing relationships with distributors in new international markets and, in select markets, selling our products direct to retail customers. We took over the distribution of our products in Germany and Austria (German market), and in France, Monaco and Andorra (French market) during 2008. In 2011, our German and French markets accounted for 6.8% and 17.0% of our consolidated net sales, respectively. Through our Belgian subsidiary, we began to sell directly to retailers in Italy during the fourth quarter of 2009, and directly to retailers in Spain and Portugal in 2011. In 2011, our Italian market accounted for 19.6% of our consolidated net sales. Spain and Portugal accounted for less than 1% of our consolidated net sales. We began taking steps in the first quarter of 2012 to close our office in Brussels and transition our business operations conducted through that office to our French and German offices.

In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011. Prior to then, our products were sold through an independent distributor in Japan. In 2011, our Japan market accounted for 5.9% of our total consolidated net sales.

In 2011, Oxylane Group accounted for 11.7% of our consolidated net sales. Oxylane Group is a French sporting goods retail chain operating under the name Decathlon. No other retail customer or independent distributor accounted for 10% or more of our consolidated net sales during 2011.

Sales to our customers in the German, French, Italian, Spain and Portugal markets are denominated in Euro. Sales to our independent distributors in the other Europe, Middle East and African ("EMEA") countries are denominated in U.S. dollars. Sales to our independent distributors in non-EMEA markets continue to be processed at our office in Carrollton, Texas and are denominated in U.S. dollars. Sales to our customers in the Japanese market are denominated in Japanese Yen. Payments are required to be made in the same currency as invoiced.

During the second quarter of 2010, we began selling certain styles of our products through our website at www.heelys.com.

Cost of Sales and Gross Profit

Cost of sales consists primarily of the cost to purchase finished products from our independent manufacturers. Cost of sales also includes shipping and handling costs that are directly attributable to the procurement of inventory, including inbound freight, and inventory reserves for shrinkage and write-downs.

We source all of our products from manufacturers located in China. Our product costs are largely driven by the prices we negotiate with our independent manufacturers. Each season, we negotiate a unit price for each model of HEELYS-wheeled footwear. Factors that influence these prices include raw materials, labor costs and foreign exchange rates. We believe our sourcing model allows us to minimize our capital investment, retain production flexibility, cost-effectiveness and scalability inherent in the use of independent manufacturers and focus our resources on developing new products and enhancing our HEELYS brand image.

In May 2010, we entered into an agreement with TGB, LLC, a New Jersey limited liability company ("TGB"), under which TGB acted as the exclusive sourcer of our shoe products. In April 2011, we reached an agreement with TGB to terminate this sourcing agreement. From and after the termination of that sourcing agreement, we were not required to (and did not) purchase any other products from TGB and, instead, we began to purchase products directly from independent manufacturers.

We purchase all of our shoe products as finished goods directly from independent manufacturers. These purchases are coordinated through our employees in China.

When demand for our products slows, we may elect to discount our products to reduce our inventory, which causes our gross profit as a percentage of net sales, or gross margin, to decline. Our gross margin is affected by our sourcing costs, our product mix and our ability to avoid excess inventory by accurately forecasting demand for our products. The unit prices we charge our domestic and international retail customers are generally higher than we charge our independent distributors for similar products, because our independent distributors are responsible for distribution and marketing costs relating to our products.

Our inventories are stated at the lower of cost or market. Inventory quantities are regularly reviewed and provisions for excess or obsolete inventory are recorded primarily based on the forecast of future demand and market conditions. If we estimate the net realizable value of our inventory is less than the cost of the inventory recorded on our books, we charge cost of sales for the difference between the cost of the inventory and the estimated net realizable value. If changes in market conditions result in reductions in the estimated net realizable value of our inventory below our previous estimate, we would write-down the inventory in the period in which we made such a determination and charge cost of sales.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of wages and related payroll and employee benefit costs, sales and marketing expenses, advertising costs, travel and insurance expenses, shipping and handling costs that are not directly attributable to the procurement of inventory, product development costs, costs to enforce our intellectual property rights, depreciation, amortization, professional fees, facility expenses and costs associated with operating as a public company.

Generally accepted accounting principles require the measurement of compensation expense of stock-based compensation awards based on the estimated fair value of that award on the date of grant. For stock options, we recognize this compensation expense using the straight-line method over the period during which the employee is required to provide service in exchange for the award. No compensation expense is recognized for stock option awards for which the employee does not render the required service. If the requisite service is not provided, previously recognized compensation expense is reversed. For all stock option awards granted to-date, the requisite service period is the same as the vesting period of the award. For restricted stock units (designated as performance awards), we recognize compensation expense using the straight-line method over the performance period. The amount of compensation expense recognized is based upon the estimated number of restricted stock units expected to be earned. The Company reassesses this estimate at each reporting period and adjusts the total amount of compensation expense to be recognized accordingly.

Our selling, general and administrative expenses may increase in future periods as we hire additional personnel, develop our infrastructure, increase our brand recognition through marketing, increase our product development efforts, secure and enforce our intellectual property rights and incur expenses associated with operating as a public company.

During the first quarter of 2011, we began to sell directly to retailers in Portugal and Spain through an independent agent who is paid commissions on those sales. For 2011, sales in these markets have been limited. As sales increase, our selling expenses will increase. Additionally, because sales to these retailers will generally be fulfilled out of our warehouse in Belgium, we would expect that our shipping and handling costs, which are included in general and administrative expense, will also increase. Because we generally are able to charge higher unit prices to international retail customers than we charge our independent distributors for similar products, we expect there to be a positive impact on our gross margin.

Income Taxes

We operate through Heeling Sports Limited, a Texas limited partnership, and as such we are subject to Texas franchise taxes on gross margin sourced to the State of Texas. In addition, the Company is subject to income taxes in certain other states as a result of business activities being performed in those states. In 2008, the Company formed a subsidiary in Belgium, with branch offices in Germany and France, to function as the headquarters for sales operations for Europe, the Middle East and Africa. As a result, we have been subject to income tax in Belgium, Germany and France since 2008 and will be subject to those taxes as long as we have operations in these jurisdictions. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011, and, as a result we are now subject to income tax in Japan. Increased activities in foreign jurisdictions or the formation of additional foreign subsidiaries could cause us to be liable for income taxes in additional jurisdictions.

Highlights of fiscal year ended December 31, 2011:

- Consolidated net sales increased $1.6 million in 2011, or 5.2% from prior year. This increase was led by improved U.S. sales of $3.3 million, or 37.8% from prior year; offset by a $1.7 million, or 7.7%, decrease in international sales. The drop in international sales was primarily the result of a decline in sales in our Japanese market.

- Gross margin percentage remained consistent at 41.6% year-on-year.

- Selling and marketing expense increased $1.5 million in 2011. Domestic sales and marketing expense increased $0.2 million in 2011, the result of additional sales commissions related to the increase in domestic sales from prior year. International marketing expense increased $1.2 million, primarily due to increased commission expense related to the increase in sales in Italy from prior year and the sales and marketing expenses associated with the Japan office opened in the first quarter of 2011. This increase was offset by decreases in promotional marketing in Europe.

- General and administrative costs increased $0.6 million in 2011. The increase was primarily the result of higher distribution costs associated with the increase in sales in the United States and Italy and the costs related to the opening of the Japan office during Q1 of 2011.

- Net loss for the year was $5.6 million, $1.6 million greater than prior year. The increased loss was primarily the result of costs associated with the opening of the Japan office in 2011, and $1.2 million in inventory impairment charges and related reserve adjustments, including $812,000 attributable to the inventory purchased in the first quarter of 2011 from our previous Japanese distributor.

- Cash and investments decreased $9.2 million in 2011. The change in cash and investments was the result of 2011 operating losses combined with an increase in receivables of $4.0 million relating to higher Q4 sales and an increase in inventories of $3.3 million to support sales in the first half of 2012, offset by a decrease in accounts payable and accrued liabilities of $1.3 million and $1.5 million, respectively.

International Efficiency and Cost Reduction Initiative

As part of an initiative to improve efficiency and reduce costs, we began taking steps in the first quarter of 2012 to close our office in Brussels, Belgium and transition our business operations conducted through that office to our French and German offices. As part of this initiative, the Company expects to reduce its workforce in Belgium. These workforce reductions will primarily come from the elimination of certain finance, supply chain and customer service functions. The work performed by these persons mostly will be absorbed by our French, German and U.S. office employees, and we anticipate hiring limited personnel to assist with accounting and logistical support in those offices. Financial management and reporting for our Belgian subsidiary will be transitioned to our headquarters in the United States. The actions taken thus far to implement this initiative are expected to be substantially completed by June 30, 2012, with the total cumulative pre-tax costs estimated to be $0.9 million to $1.3 million. The Company currently anticipates that approximately 90% of these costs will relate to cash outlays, primarily related to employee separation expense and professional fees. The Company does not anticipate that the actions taken thus far with respect to the initiative will result in annual savings in 2012, but estimates annual savings of approximately $1.5 million in future years.

Comparison of the Years Ended December 31, 2011 and 2010

Net Sales

	Year Ended December 31,	
	2011	2010
Net Sales (in thousands)		
Domestic	$ 11,903	$ 8,641
International	20,114	21,795
Consolidated	$ 32,017	$ 30,436
Net Sales (as % of Consolidated Net Sales)		
Domestic	37.2%	28.4%
International	62.8%	71.6%
	100.0%	100.0%

	Year Ended December 31,	
	2011	2010
Pairs Sold		
Domestic	472,000	367,000
International	532,000	669,000
Consolidated	1,004,000	1,036,000

Domestically, our net sales increased $3.3 million, or 37.8%, from $8.6 million in 2010, to $11.9 million in 2011. This increase was primarily the result of increased unit sales of our HEELYS-wheeled footwear and an increase in the average sales price per pair sold. Unit sales of our HEELYS-wheeled footwear increased by 105,000 pairs, or 28.6%, from 367,000 pairs in 2010, to 472,000 pairs in 2011, primarily as a result of expanded placement, when compared to last year, in existing and new retail outlets, as well as the sale of our new brand, Sidewalk Sports™. We sold 43,000 pairs of our Sidewalk Sports™ wheeled footwear, which was sold exclusively through a discount retailer for the 2011 Holiday season. The increase in average sales price per pair is primarily attributable to reduced sales of aged inventory to a discount retailer. During 2010 we sold 63,000 pairs of certain older styles of our wheeled-footwear at a reduced price per pair to this retailer. We did not sell any product to this retailer during 2011. The increase in average sales price per pair, resulting from reduced sales of aged inventory, was offset by the impact of the sale of our Sidewalk Sports™ wheeled footwear which sells for less than our other wheeled products.

Internationally, our net sales decreased $1.7 million, or 7.7%, to $20.1 million in 2011, from $21.8 million in 2010. This decrease was primarily the result of lower unit sales of our HEELYS-wheeled footwear. Unit sales in our non-EMEA markets decreased 174,000 pairs to 88,000 pairs in 2011, from 262,000 pairs in 2010, which is primarily attributable to a decrease in pairs sold in our Japanese market which decreased 167,000 pairs to 48,000 pairs in 2011, from 215,000 pairs in 2010. We took over direct distribution in the Japanese market effective March 1, 2011. Prior to then, our products were sold through an independent distributor. We believe the decrease in sales in the Japanese market is due to the transition from distribution through an independent distributor to direct distribution and the impact of the earthquake and tsunami-related events in Japan, which resulted in business disruptions during the year. We believe the March 2011 earthquake in Japan, and related tsunami, nuclear and other disasters in the region impacted consumer buying behavior with reduced discretionary spending and purchases of non-essential items. We do not believe the earthquake and tsunami-related events in Japan will continue to have a significant impact on consumer buying behavior. Unit sales in our German and French markets decreased 85,000 pairs, or 34.3%, to 163,000 pairs in 2011, from 248,000 pairs in 2010. We believe the decrease in unit sales in both our German and French markets is primarily due to retailers being more cautious when placing orders to minimize their inventory levels and inventory related risks resulting from a decrease in consumer demand, which we believe is due to market competition from other wheeled products such as coaster boards. These decreases in unit sales were offset by increases in unit sales in our Italian market and to independent distributors in our EMEA markets. Unit sales in our Italian market increased 84,000 pairs, from 55,000 pairs in 2010, to 139,000 pairs in 2011. The increase in pairs sold in the Italian market is attributable to market expansion. Unit sales to independent distributors in our EMEA markets increased 36,000 pairs, from 104,000 pairs in 2010, to 140,000 pairs in 2011, which was primarily due to increased sales to our independent distributor in the United Kingdom (increase of 30,000 pairs sold) and sales to our new independent distributor in the United Arab Emirates (10,000 pairs sold).

Gross Profit

	Year Ended December 31,	
	2011	2010
Gross Profit (in thousands)		
Domestic	$ 4,704	$ 2,608
International	8,616	10,045
Consolidated	$ 13,320	$ 12,653
Gross Profit (%)		
Domestic	39.5%	30.2%
International	42.8%	46.1%
Consolidated	41.6%	41.6%

Domestically, gross profit margin increased from 30.2% for 2010, to 39.5% for 2011. The increase in gross profit margin is a result of a higher average price per pair sold as a result of a decrease in sales to a discount retailer. In 2010 we sold 63,000 pairs to a discount retailer. In connection with these sales we recorded inventory markdowns (in order to properly state our inventories at lower of cost or market) of $352,000 in 2010. We did not sell any product to this discount retailer during 2011. During 2011, we recognized inventory impairment charges and related inventory valuation reserve adjustments in the amount of $57,000.

Internationally, gross profit margin decreased to 42.8% for 2011, from 46.1% for 2010. Fluctuations in the exchange rate between the U.S. dollar ("USD") and the Euro impacts our inventory cost. We pay for our inventory in USD and sell to customers in our German, French and Italian markets in Euro. During 2011, we sold inventory in these markets that we had purchased in 2010 when the exchange rate (USD to Euro) was higher, which resulted in a higher inventory value and lower margins on those sales. We sell to our independent distributors in USD. Historically, fulfillment of sales to independent distributors is direct from the manufacturer with the purchase of inventory and sale occurring virtually simultaneously and therefore the translated Euro value of the purchase of the inventory in USD and the Euro value of the sale in USD moves together and margins are maintained. However, during 2011, we fulfilled some distributor sales from our warehouse in Belgium with inventory we had purchased in 2010 when the exchange rate (USD to Euro) was higher, which resulted in higher inventory value than if that inventory had been purchased during the current year. So, while the USD value of these sales to distributors remained the same, the Euro value decreased, which resulted in lower margins on those sales. Additionally, we saw lower average sales prices in our Italian market resulting from changes in customer mix, with greater sales to larger customers who benefit from discount programs. Also, during 2011, we incurred approximately $348,000 to destroy damaged and older inventory items and sold certain of our slow moving and older inventory styles in our Japanese market at lower margins in order to reduce our excess inventories. Additionally, in late 2010 we began selling our two-wheeled footwear in the French market. This product has a higher manufacturing cost and sells at lower price points than our traditional one-wheeled footwear, resulting in lower gross profit margins on these sales. During 2011, we recognized $841,000 in inventory impairment and related inventory valuation reserve adjustments, which was primarily attributable to inventory we purchased during the first quarter from our former independent distributor in Japan.

Sales and Marketing Expense

	Year Ended December 31,	
	2011	2010
Selling & Marketing (in thousands)		
Domestic	$ 3,817	$ 3,576
International	4,934	3,715
Consolidated	$ 8,751	$ 7,291

Domestically, selling and marketing expense, excluding commissions and payroll and payroll related expenses, remained consistent at $2.4 million for the years ended December 31, 2011 and 2010. During 2011, we decreased advertising and marketing spend for our HX2™ two wheeled-footwear and Nano™ inline footboard, which received additional advertising and marketing support in 2010 during their new product launches, but increased advertising and marketing of our core HEELYS wheeled-footwear.

Internationally, selling and marketing expense, excluding commissions and payroll and payroll related expenses, increased $201,000 from $1.9 million in 2010, to $2.1 million in 2011. We recognized $536,000 in selling and marketing expenses, excluding commissions and payroll and payroll related expenses, directly attributable to our office in Japan which we opened during the first quarter of 2011. Of this amount approximately $469,000 was for consumer advertising and related costs (including event marketing) including approximately $55,000 for a marketing event for one of our Japanese customers during the third quarter and approximately $68,000 resulting from our participation in a Dance Nation event held on December 24, 2011. Selling and marketing expenses, excluding commissions and payroll and payroll related expenses, directly attributable to our Belgian subsidiary decreased $329,000 to $1.6 million in 2011, from $1.9 million in 2010. This decrease was primarily due to management's decision to reduce consumer advertising during the fourth quarter in our German and French markets as a result of decreased consumer demand.

Commissions on domestic sales increased $161,000, or 43.8%, from $368,000 in 2010, to $529,000 in 2011. The increase in commissions is primarily due to the increase in domestic sales on which commissions are paid.

Internationally, commissions increased $624,000 from $845,000 in 2010, to $1.5 million in 2011, primarily due to increased sales in the Italian market where we sell directly to retailers through an independent agent who is paid commissions on those sales. Commission expense is impacted by increases and decreases in sales as well as changes in product and customer mix due to differing commission rates paid on those sales.

Payroll and payroll related expenses attributable to our domestic operations increased $33,000 from $848,000 in 2010, to $881,000 in 2011. Payroll and payroll related costs attributable to our international operations increased $394,000 from $955,000 in 2010, to $1.3 million in 2011, primarily as a result of the opening of our office in Japan.

General and Administrative Expense

	Year Ended December 31,	
	2011	2010
General & Administrative (in thousands)		
Domestic	$ 4,577	$ 5,070
International	5,172	4,153
Unallocated	986	883
Consolidated	$ 10,735	$ 10,106

Consolidated general and administrative expenses, excluding unallocated costs, increased $526,000 from $9.2 million in 2010, to $9.8 million in 2011.

Consolidated shipping and handling costs increased $589,000 from $2.0 million in 2010, to $2.5 million in 2011. Shipping and handling costs attributable to our EMEA operations accounted for $270,000 of the increase, primarily as a result of an increase in shipments out of our warehouse in Belgium to fulfill sales to retailers in our Italian market. Inventory handling related costs directly attributable to the opening of our Japan operations, including order fulfillment, accounted for $272,000 of the increase.

Legal and other fees related to our intellectual property and associated enforcement efforts decreased $706,000 to $472,000 in 2011, from $1.2 million in 2010. These decreases are a combination of differing enforcement actions during the periods and an overall cost containment effort by management.

Payroll and payroll related costs attributed to our domestic employees decreased $193,000 to $2.1 million in 2011, from $2.3 million in 2010. Payroll and payroll related costs attributed to our Belgian subsidiary (including branch offices in Germany and France) increased $52,000 from $946,000 in 2010, to $1.0 million in 2011. Payroll and payroll related costs attributed to our Japan operations were $210,000 in 2011.

Unallocated costs are those costs that are directly attributable to operating as a public company, as well as professional fees incurred at the consolidated level, including fees for tax, accounting and other consulting and professional services.

Other Expense (Income)

	Year Ended December 31,	
	2011	2010
Other (Income) Expense (in thousands)		
Interest (income) expense, net	$ (274)	$ (355)
Other (income) expense, net	(525)	(818)
Exchange (gain) loss, net	(6)	153
Consolidated	$ (805)	$ (1,020)

The decrease in interest income (expense), net is primarily the result of a $87,000 decrease in interest income to $307,000 in 2011, from $394,000 in 2010.

Other income is the result of settlements of patent and trademark litigation. Litigation settlement payments related to intellectual property legal matters (whether received by the Company or paid by the Company) are reported as other income (expense). Legal fees related to intellectual property matters and associated enforcement are included in general and administrative expenses. We recognized $575,000 and $822,000 in other income resulting from litigation settlement payments in the Company's favor in 2011 and 2010, respectively, which included a settlement of a potential patent and trademark lawsuit in the amount of $375,000 during the third quarter of 2011 and $750,000 during the second quarter of 2010 for the settlement of another potential patent and trademark lawsuit.

Gains (losses) resulting from foreign currency transactions are mainly attributable to intercompany loans due to our U.S. entity from our Belgian and Japanese subsidiaries, which must be repaid in U.S. dollars.

Income Taxes

We recognized income tax expense of $239,000, effective tax rate of (4.5%), in 2011; compared to an income tax expense of $267,000, effective tax rate of (7.2%), in 2010. Our effective rate differs from the statutory federal rate of 35% primarily due to domestic and international operating losses for which no tax benefits have been recognized and foreign taxes at rates other than 35%, as well as for certain other items such as state and local taxes and non-deductible expenses. While we did not record the benefit of losses in the United States and Japan for the current year, profits in our French and Belgian operations, offset by losses in our German operations, resulted in net income tax expense of $239,000 for the fiscal year ended December 31, 2011. We operate in multiple jurisdictions and have seasonality in our business which causes variability in our consolidated effective tax rate during the year. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011, and, as a result, we are now subject to income tax in Japan. Increased activities in foreign jurisdictions or the formation of additional foreign subsidiaries could cause us to be liable for income taxes in additional jurisdictions.

Liquidity and Capital Resources

Our primary cash need is for working capital, which we generally fund with cash flow from operating activities, and may be impacted by fluctuations in demand for our products, investments in our infrastructure

and expenditures on marketing and advertising. At December 31, 2011, we had a total of $17.9 million in cash and cash equivalents and $40.5 million in current investments. Our current investments will mature during the next 12 months and include investments in debt securities ($40.0 million) and a certificate of deposit ($500,000).

The Company has established an investment policy, the purpose of which is to establish sound investment guidelines for the ongoing management of the Company's excess cash and investments. The policy provides guidelines on, among other things, investment term limitations, permitted investments, credit quality, single issuer concentration and corporate debt sector concentrations. In all categories of investments, emphasis is placed on securities of high quality subject to the following quality limitations at the time of investment:

- U.S. Treasury and other U.S. Federal Agencies, debentures or mortgages;
- $1 net asset value money market mutual funds governed by SEC Rule 2a-7;
- Commercial Paper (minimum A-1/P-1/F-10); Corporate Notes (minimum A or better): and
- Municipal Debt (short-term: minimum A-1/P-1 or equivalent; long term: A or better).

Cash used in operating activities for the year ended December 31, 2011 was $8.3 million compared to cash provided of $2.7 million for the year ended December 31, 2010. Cash flows from operating activities are comprised of net loss adjusted for non-cash items and changes in operating assets and liabilities. The 2011 loss included $1.2 million in inventory impairment charges and related inventory valuation reserve adjustments, including $812,000 attributable to the inventory we purchased during the first quarter of 2011 from our former distributor in Japan.

The increase in accounts receivables is due to increased sales as well as timing. The increase in inventory is primarily to support sales in the first half of 2012. The increase in accounts payable and accrued liabilities is primarily due to inventory purchases. During the third quarter of 2011, we settled a potential patent and trademark lawsuit, in the Company's favor, in the amount of $375,000. The full amount of the settlement was received during the third quarter of 2011.

Net cash provided by changes in operating assets and liabilities for the year ended December 31, 2010 was primarily due to the collection of a $2.9 million federal income tax refund for the carryback of 2008 net operating losses to 2006 offset by $1.2 million settlement of outstanding state tax liabilities. The reduction in net accounts receivable was due to timing as well as reduced sales. The increase in inventory during 2010 was primarily due to an increase in inventory levels in our Belgian warehouse due to lower than expected sales during December 2010 as well as the need to maintain higher inventory levels to meet the demand of our international retailers. Additionally, we had approximately $841,000 of inventory being held in China which we agreed to purchase as a result of an order cancellation by our former independent distributor in Japan. During the fourth quarter of 2010, we received a federal income tax refund of $3.1 million for the carryback of 2009 net operating losses to 2007.

As of December 31, 2011, we had open purchase commitments of $3.8 million for the purchase of inventory, the majority of which are expected to be settled during the first quarter of 2012.

Cash flows provided by and used in operating activities is subject to seasonality.

Net cash used in investing activities of $9.0 million for the year ended December 31, 2011, and $6.1 million for the year ended December 31, 2010, is primarily the result of purchases of investments, offset by proceeds from investments that matured during the respective periods.

Cash used in financing activities for the years ended December 31, 2011 and 2010, was for payments of our previously acquired goodwill and intangibles associated with the termination of agreements with our former independent distributors in the German and French markets in 2008. As of December 31, 2011, we have outstanding liabilities of $214,000 due to our former independent distributor in the German market, $93,000 of

which are recorded as a current liabilities and are expected to be settled during the next 12 months. All liabilities due to our former independent distributor in the French market have been settled.

We believe our cash flows from operating activities, together with the cash on hand (including cash equivalents) and investments, will be sufficient to meet our liquidity needs and capital expenditure requirements for at least the next 12 months.

Operating Leases and Related Obligations

Leases

We lease our corporate headquarters, an approximately 48,400 square-foot facility located in Carrollton, Texas, consisting of approximately 34,500 square feet of warehouse space and approximately 13,900 square feet of office space. Our lease expires in August 2015, but we have two five-year extension options. The lease for our corporate headquarters provides that if we are in default of the lease, we must pay certain damages to the landlord, and the landlord may elect to require us to continue to pay rent through the end of the lease term or to pay the present value of the excess, if any, of the aggregate rent otherwise payable through the end of the lease over the aggregate fair market value of the premises for the lease period.

Effective May 1, 2008, our Belgian subsidiary entered into an operating lease for office space in Brussels, Belgium for nine years with the option to terminate the lease at the end of each three year period. This lease was not terminated at the end of the first three year period. Payments under this lease agreement are made in Euro. While we have begun taking steps in the first quarter of 2012 to close our Belgian office, and transition our business operations conducted through that office to our French and German offices, we have not terminated our operating lease for our Belgian office.

Effective April 1, 2008, our Belgian subsidiary entered into an operating lease for office space in Munich, Germany for three years with an automatic renewal at the end of the initial three year lease unless six months notice is provided. This lease was renewed for a one year period from April 1, 2011 through March 31, 2012 and has been renewed for another period of one year from April 1, 2012 through March 31, 2013. Payments under this lease agreement are made in Euro.

Effective May 1, 2008, our Belgian subsidiary entered into an operating lease for office space in Annecy, France for nine years with the option to terminate the lease at the end of each three year period. This lease was not terminated at the end of the original three year period. Payments under this lease agreement are made in Euro.

On March 1, 2011, our Japanese subsidiary entered into an operating lease for office space in Tokyo, Japan for two years with an automatic renewal at the end of the initial two year lease, unless six months notice is provided. Payments under this lease agreement are made in Japanese Yen.

Third-Party Distribution Arrangements

We use a third-party distribution facility in Belgium and pay this third-party distributor fees and charges for services including storage, handling, processing and packing materials. These fees and charges are activity based and therefore fluctuate and as a result related future obligations cannot be quantified. This agreement is for one year with automatic one year renewal terms. We expensed $1.6 million and $1.3 million related to this third-party distribution facility in 2011 and in 2010, respectively.

We use a third-party distribution facility in Japan and pay this third-party distributor a monthly management fee as well as fees and charges for services, including storage, handling, processing and packing materials. Other than the monthly management fee, these fees and charges are activity-based and fluctuate; as a result the related future obligations for these fees and charges cannot be quantified. Our agreement with this

distributor is for one year with automatic one year renewal terms. We expensed $191,000 related to this third-party distribution facility in 2011.

Purchase Commitments

At December 31, 2011, we had open purchase commitments of $3.8 million for inventory purchases.

Termination of Distributorship Agreements

Effective March 31, 2008, we entered into agreements to terminate our arrangement regarding the distribution of Heelys-branded footwear and products in Germany and Austria, allowing us to market, through our Belgian subsidiary, our products directly in such countries. This included a Termination Agreement (the "Termination Agreement") with The Territory Distribution GmbH (the "Distributor"), and Achim Lippoth, the sole owner of the Distributor ("Lippoth"), pursuant to which, among other things, a prior Distributor Agreement between the Company and the Distributor was terminated, we agreed to purchase from the Distributor all of the Distributor's inventory of unsold Heelys products and other specified assets for the Distributor's cost, and all of the unshipped orders for Heelys products on the Distributor's order book as of March 31, 2008 for a price equal to the Distributor's net wholesale margin on such unshipped orders, and the Distributor and Lippoth agreed, until March 31, 2010, not to compete with us relating to the Company's products anywhere in the world. In connection with the Termination Agreement we entered into two consulting agreements, one with The Sansean Group Limited ("Sansean"), and one with Lippoth, pursuant to which, among other things, Sansean and Lippoth agreed to perform certain consulting services and we agreed to pay Sansean and Lippoth consulting fees as set forth in their respective consulting agreements. Payments under these agreements are to be made in Euro.

Effective April 30, 2008, we entered into agreements to terminate our current arrangement regarding the distribution of Heelys-branded footwear and products in France, Monaco and Andorra, allowing our company, through our Belgian subsidiary, to market products directly in such countries. This included a Termination Agreement (the "Termination Agreement") with Trotwood Import/Export (the "Distributor"), Trotwood Investments Ltd., the sole owner of the Distributor ("TIL"), and David Stanley ("D. Stanley") and Margarete Stanley ("M. Stanley"), pursuant to which, among other things, a prior International Distributor Agreement between our company and the Distributor was terminated, we agreed to purchase from the Distributor all of the Distributor's inventory of unsold Heelys products for the Distributor's cost of such products, the Distributor's order books relating to Heelys products at the value on Distributor's books and certain other incidental assets of the Distributor related to its distribution operations as described in the Termination Agreement (we agreed to pay Distributor for such items on or before May 16, 2008), we agreed to purchase from the Distributor all of the unshipped orders for Heelys products on the Distributor's order book as of April 30, 2008 that are not novated to our company or one of its affiliates for a price equal to the Distributor's net wholesale margin on such unshipped orders (which is to be paid on or before the end of the month following our receipt of payment for the Heelys products shipped in response to such unshipped orders). In addition, the Distributor, Shareholder, D. Stanley and M. Stanley agreed, until April 30, 2012, not to compete with us relating to our products anywhere in the world and we agreed to pay Distributor an additional amount set forth in the Termination Agreement for each pair of Heelys branded footwear sold by our company or its affiliates in France, Monaco and Andorra. In connection with the Termination Agreement, we entered into a Consulting Agreement with TIL pursuant to which, among other things, TIL agreed to perform certain consulting services and we agreed to pay TIL consulting fees as set forth in such consulting agreement. Payments under these agreements are to be made in Euro.

The primary assets acquired as a result of these agreements were the customer lists and goodwill. In addition, both of these former distributors agreed to not compete with the Company for a limited period of time. The fair value of the acquired assets was based upon the amount at which the assets could be bought or sold in a current transaction between willing parties. As a result, the Company recorded goodwill and intangibles (including acquired customer relationships and non-compete agreements) in the amount of $3.7 million (2.4 million Euro). As of December 31, 2011, the Company paid $3.2 million (2.2 million Euro) for these acquired assets with the balance of $214,000 (166,000 Euro) to be paid out over time in accordance with the

terms of the respective agreements; $121,000 is recorded as other long term liability and $93,000 is recorded as a current liability. As of December 31, 2011, all liabilities due to our former distributor in the French market have been settled.

On November 25, 2010, we notified Privee AG Corporation ("Privee AG"), our independent distributor in Japan, that we would not be renewing our distributor agreement with Privee AG (the "Notice"), under which Privee AG acted as our exclusive distributor in Japan (the "Agreement"). Pursuant to the Notice, the Agreement terminated on February 28, 2011, which was the expiration date of the then current term of the Agreement.

Termination of Sourcing Agreement

From May 2010 to April 2011, TGB, LLC, a New Jersey limited liability company ("TGB"), acted as the exclusive sourcer of our shoe products. From and after the termination of that sourcing agreement in April 2011, we were not required to (and did not) purchase any other products from TGB and, instead, we purchased products directly from independent manufacturers.

Seasonality

Similar to other vendors of footwear products, sales of our products are subject to seasonality. There are three major buying seasons in footwear: spring/summer, back-to-school and holiday. We offer two primary lines: spring/summer and a combined back-to-school/holiday line. A few new styles will typically be added for holiday. Shipments for spring/summer take place during the first quarter and early weeks of the second quarter, shipments for back-to-school generally begin in May and finish in late August and shipments for the holiday season begin in October and finish in early December. Historically, we have experienced greater revenues in the second half of the year than those in the first half due to a concentration of shopping around the back-to-school and holiday seasons.

Backlog

Historically, we received most of our orders three to four months prior to the date the products were shipped to customers. At December 31, 2011, our backlog was approximately $5.4 million, compared to approximately $4.9 million at December 31, 2010. Although generally these orders are not subject to cancellation prior to the date of shipment, cancellations have and may continue to occur. In the current economic environment, our retail customers are being cautious when placing orders and have shifted towards shorter lead times and at-once inventory purchases. For a variety of reasons, including the timing of release dates for our product offerings, shipments, order deadlines and receipt of orders, backlog may not be a reliable measure of future sales and may not be comparable from one period to another.

Vulnerability Due to Customer Concentration

Oxylane Group, a French sporting goods retail chain operating under the name Decathlon, accounted for 11.7% and 11.9% of our consolidated net sales for the 2011 and 2010, respectively. In 2010, Privee AG Corporation ("Privee AG") accounted for 17.7% of our consolidated net sales. Privee AG was the Company's independent distributor in Japan and we did not renew our distributor agreement with them, so that distributor agreement terminated on February 28, 2011. In February 2011, we formed Heeling Sports Japan, K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage our operations in Japan and to take over the distribution of our products in that country effective March 1, 2011. No other retail customer or independent distributor accounted for 10% or more of our net sales in either of these periods.

We took over the distribution of our products in Germany and Austria (German market) effective April 1, 2008 and in France, Monaco and Andorra (French market) effective May 1, 2008. In 2011, our German and French markets accounted for 6.8% and 17.0% of our consolidated net sales, respectively. In 2010, our German and French markets accounted for 12.4% and 21.4% of our consolidated net sales, respectively.

During the fourth quarter of 2009, we began to sell directly to retailers in Italy through our Belgian subsidiary. Our Italian market accounted for 19.6% and 8.4% of our consolidated net sales in 2011 and 2010, respectively. No other country, other than the United States, accounted for 10% or more of our consolidated net sales in either of these periods.

We anticipate that our net sales may remain concentrated for the foreseeable future. If any of our significant retail customers or independent distributors decreases its purchases of our products or stops purchasing our products our net sales and results of operations could be adversely affected.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

Critical Accounting Policies

Our management's discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, net sales and expenses and related disclosures at the date of our financial statements. We continually evaluate our estimates and judgments, including those related to net sales, collectability of accounts receivable, inventory reserve allowances, long-lived assets, income taxes and stock-based compensation. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis of our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results or changes in the estimates or other judgments of matters inherently uncertain that are included within these accounting policies could result in a significant change to the information presented in the accompanying consolidated financial statements. We believe the following discussion addresses the critical accounting policies that are necessary to understand and evaluate our reported consolidated financial results.

Revenue Recognition. Revenues are recognized when merchandise is shipped and the customer takes title and assumes risk of loss, collection of related receivables is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. Title passes upon shipment or upon receipt by the customer depending on the agreement with the customer. Revenues are stated net of discounts, marketing discretionary funds, estimated returns and other allowances, including permitted returns of damaged or defective merchandise. We base our estimates and judgments on historical experience and various other factors, including customer communications and analysis of relevant market information.

Accounts Receivable. We continually make estimates relating to the collectability of our accounts receivable, as well as estimates for customer returns, defective merchandise and allowances for co-op advertising and marketing discretionary funds. In determining these allowances, we consider our historical experience, level of credit losses and make judgments about the creditworthiness of significant customers. Because we cannot predict future changes in the financial stability of our customers, actual future losses from uncollectible accounts may differ from our estimates. If the financial condition of our customers were to deteriorate, resulting in their inability to make payments, a larger reserve might be required. If we determine that smaller or larger allowances are appropriate, these changes in estimates are recorded in the period in which such determination is made.

Inventories. Our inventories are stated at the lower of cost or market. Inventory quantities are regularly reviewed and provisions for excess or obsolete inventory are recorded primarily based on the forecast of future demand and market conditions. If we estimate the net realizable value of our inventory is less than the cost of the inventory, we record a write-down equal to the difference between the cost of the inventory and the estimated net realizable value. This write-down is recorded as cost of sales. If changes in market conditions

result in reductions in the estimated net realizable value of our inventory below our previous estimate, we would increase our write-down in the period in which we made such a determination.

Goodwill. Goodwill is not amortized but is instead measured for impairment at least annually, or when events indicate that an impairment might exist. We compare the estimated fair value of goodwill to its carrying value. Our estimates of fair value utilized in impairment testing are based upon a number of factors, including assumptions about the expected future operating performance of our reporting units. Estimates may change in future periods due to, among other things, the expected future operating performance of our reporting units, technological changes, economic conditions, changes to our business operations or inability to meet business plans. Such changes may result in impairment charges recorded in future periods. Any resulting impairment charge would be classified as a separate line item on the consolidated statement of operations for amounts necessary to reduce the carrying value of the asset to fair value. The Company performs its annual impairment test during the fourth quarter.

Stock-Based Compensation. We account for stock-based awards in accordance Financial Accounting Standards Board Accounting Standards Codification 718, "Compensation-Stock Compensation" ("ASC 718"). Under ASC 718 stock-based compensation expense is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the requisite service period. We estimate the fair value of stock option awards using a Black-Scholes option pricing model that includes the following variables: 1) exercise price of the instrument, 2) fair market value of the underlying stock on date of grant, 3) expected life, 4) estimated volatility and 5) the risk-free interest rate. We recognize compensation expense attributable to stock option awards using the straight-line method over the period during which the employee is required to provide service in exchange for the award. No compensation expense is recognized for stock option awards for which the employee does not render the required service. If the requisite service is not provided, previously recognized compensation expense is reversed. In 2010 and 2011, we granted restricted stock units which are designated as performance awards. We determine the fair value of restricted stock unit awards based on the closing trade price of the Company's common stock on the date of grant. We recognize compensation expense attributable to restricted stock unit awards using the straight-line method over the performance period. The amount of compensation expense recognized is based upon the estimated number of restricted stock units expected to be earned. We reassess this estimate at each reporting period and adjust the total amount of compensation expense to be recognized accordingly.

Income Taxes. Tax laws require items to be included in our tax returns at different times than when these items are reflected in the consolidated financial statements. Some of these differences are permanent, such as expenses that are not deductible in our tax return, and some differences reverse over time, such as depreciation expense. These timing differences create deferred tax assets and liabilities. We assess the realizability of our deferred tax assets to determine whether a valuation allowance is required. Based on all available evidence, both positive and negative, and the weight of that evidence to the extent such evidence can be objectively verified, if we determine it is more likely than not the deferred tax asset will not be realized, a valuation allowance is established. We follow guidance provided by Financial Accounting Standards Board Accounting Standards Codification 740, "Income Taxes" ("ASC 740"). ASC 740 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the Company has taken or expects to take on a tax return. The impact of an uncertain tax position that is more likely than not of being sustained upon examination by the relevant taxing authority is recognized at the largest amount that is more likely than not to be sustained. An uncertain tax position is not recognized if the position has less than a 50% likelihood of being sustained. Also, under ASC 740, interest expense is recognized on the full amount of deferred benefits for uncertain tax positions. We adjust our reserves for uncertain tax positions in light of changing facts and circumstances; however, due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. If our estimate of tax liabilities proves to be less than the ultimate assessment, an additional charge would result. If payment of these amounts ultimately proves to be less than the recorded amounts, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary. We recognize interest accrued related to recognized uncertain tax positions in interest

expense and related penalties in general and administrative expense. Accrued interest and penalties are included within the related tax liability line in the consolidated balance sheet.

Recent Accounting Pronouncements

See Note 3 in the Notes to Consolidated Financial Statements for information regarding recently issued accounting pronouncements.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

We are a Smaller Reporting Company as defined in Rule 12b-2 of the Securities Exchange Act of 1934 and are not required to provide information under this Item.

Item 8. Consolidated Financial Statements and Supplementary Data

Information with respect to this Item is set forth beginning on page F-1.

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

None.

Item 9A . Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The term "disclosure controls and procedures" refers to the controls and other procedures of a company that are designed to provide reasonable assurance that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported within required time periods. We have established disclosure controls and procedures to ensure that material information relating to Heelys, Inc. and its consolidated subsidiaries is made known to the officers who certify our financial reports, as well as other members of our senior management and Board of Directors, to allow timely decisions regarding required disclosures. As of the end of the period covered by this Annual Report on Form 10-K, we carried out an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within required time periods, and that it is made known to our officers who certify our financial reports, as well as other members of our senior management and Board of Directors, to allow timely decisions regarding required disclosures.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors or fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by

management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Changes in Internal Control over Financial Reporting

There were no changes to our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting during the fourth quarter of 2011. We have completed our efforts regarding compliance with Section 404 of the Sarbanes-Oxley Act of 2002 for the year ended December 31, 2011. The results of our evaluation are discussed below in Management's Report on Internal Control Over Financial Reporting.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

We conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Framework"). Based on our evaluation under the COSO Framework, our management has concluded that as of December 31, 2011, our internal control over financial reporting is effective.

This Annual Report on Form 10-K does not include an attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting. The preceding management's report was not subject to attestation by our independent registered public accounting firm in accordance with recent amendments to Section 404 of the Sarbanes-Oxley Act of 2002 pursuant to Section 989G of the Dodd-Frank Wall Street Reform and Consumer Protection Act that permit us to provide only our management's report in this Annual Report.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

Incorporated by reference from the information in our proxy statement for the 2012 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report on Form 10-K relates.

Code of Business Conduct and Ethics

We have adopted a code of business conduct and ethics that applies to all of our officers, directors and employees. Our code of business conduct and ethics is posted on our website at www.heelys.com and we will send a paper copy to any stockholder who submits a request in writing to our Secretary. If we make any substantive amendments to this code of conduct or if we grant any waivers from a provision of such code of conduct to any director or executive officer, we will promptly disclose the nature of the amendment or waiver on our website at the address provided above.

Item 11. Executive Compensation

Incorporated by reference from the information in our proxy statement for the 2012 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report on Form 10-K relates.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Incorporated by reference from the information in our proxy statement for the 2012 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report on Form 10-K relates.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Incorporated by reference from the information in our proxy statement for the 2012 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report on Form 10-K relates.

Item 14. Principal Accounting Fees and Services

Incorporated by reference from the information in our proxy statement for the 2012 Annual Meeting of Stockholders, which we will file with the SEC within 120 days of the end of the fiscal year to which this Annual Report on Form 10-K relates.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a)(1) Financial Statements

The following documents are filed as a part of this report:
Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets as of December 31, 2011 and December 31, 2010
Consolidated Statements of Operations for the Years ended December 31, 2011 and 2010
Consolidated Statements of Stockholders' Equity and Comprehensive Loss for the Years ended December 31, 2010 and 2011
Consolidated Statements of Cash Flows for the Years ended December 31, 2011 and 2010
Notes to Consolidated Financial Statements

(2) Financial Statement Schedules

Financial statement schedules have been omitted because they either are not applicable or the required information is included in the consolidated financial statements or notes thereto.

(3) Exhibits

(a) The following exhibits are incorporated by reference or filed herewith. References to the Form S-1 are to the Registrant's Registration Statement on Form S-1 (File No. 333-137046), filed with the Securities and Exchange Commission (SEC) on September 1, 2006. References to Amendment No. 1 to Form S-1 are to Amendment No. 1 to the Form S-1 filed with the SEC on October 4, 2006. References to Amendment No. 2 to Form S-1 are to Amendment No. 2 to the Form S-1 filed with the SEC on October 27, 2006. References to Amendment No. 3 to Form S-1 are to Amendment No. 3 to the Form S-1 filed with the SEC on November 24, 2006.

Exhibit No.	Description
3.1	Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 to the Form S-1).
3.2	Amended and Restated By-Laws of the Registrant (incorporated by reference to Exhibit 3.1 of Registrant's Current Report on Form 8-K filed November 13, 2009).
4.1	Form of Registrant's Common Stock certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 3 to the Form S-1).
10.1	Registration Rights Agreement, dated May 26, 2000, among the Registrant, Samuel B. Ligon and Patricia P. Ligon and Capital Southwest Venture Corporation (incorporated by reference to Exhibit 10.1 to the Form S-1).
10.2	Lease Agreement, dated November 4, 2004, between CP Commercial Properties—XIX, Inc. and Heeling Sports, Limited, as amended by the First Amendment to Lease Agreement, dated February 27, 2006, for 3200 Belmeade, Suite 100, Carrollton, Texas (incorporated by reference to Exhibit 10.5 to the Form S-1).
10.3	Letter Agreement, dated June 28, 2006, by and between Richard E. Middlekauff and Roger R. Adams, and approved by the Registrant (incorporated by reference to Exhibit 10.9 to the Form S-1).
10.4	Waiver and Agreement, dated as of September 14, 2006, among the Registrant, Roger R. Adams, Richard E. Middlekauff, Robert J. Ward, CYPO, Inc., Heeling Holding Corporation, Heeling Management Corporation, Samuel B. Ligon and Patricia P. Ligon and Capital Southwest Venture Corporation (incorporated by reference to Exhibit 10.15 to Amendment No. 3 to the Form S-1).

10.5 2006 Stock Incentive Plan, as amended by Amendment to Heeling, Inc. 2006 Stock Incentive Plan and form of Stock Option Agreement thereunder (incorporated by reference to Exhibit 10.16 to the Form S-1).*

10.6 Form of Indemnification Agreement entered into by the Registrant with each of its directors and executive officers (incorporated by reference to Exhibit 10.18 to the Form S-1).*

10.7 Investor Rights Agreement, dated as of May 24, 2000, among the Registrant, Roger R. Adams, Richard E. Middlekauff, Robert J. Ward, Cypo, Inc., Heeling Holding Corporation, Heeling Management Corp., Samuel P. Ligon and Patricia P. Ligon and Capital Southwest Venture Corporation (incorporated by reference to Exhibit 10.20 to Amendment No. 2 to the Form S-1).

10.8 Severance and General Release Agreement dated as of February 1, 2008, between Michael G. Staffaroni and Heeling Sports Limited (incorporated by reference to Exhibit 10.4 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010 filed on August 13, 2010).*

10.9 Settlement Agreement and Technology License Agreement dated as of March 11, 2008, between Heeling Sports Limited and Elan-Polo, Inc. (incorporated by reference to Exhibit 10.2 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 filed on May 12, 2008) (The Securities and Exchange Commission has granted confidential treatment for a portion of this document. A complete version of this document has been filed separately with the Securities and Exchange Commission.)

10.10 Termination Agreement dated as of March 13, 2008, between Heeling Sports Limited and The Territory Distribution GmbH (the "Distributor") and Achim Lippoth, a German individual and the sole owner of the Distributor. (incorporated by reference to Exhibit 10.3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 filed on May 12, 2008) (The Securities and Exchange Commission has granted confidential treatment for a portion of this document. A complete version of this document has been filed separately with the Securities and Exchange Commission.)

10.11 Consulting Agreement dated as of March 31, 2008, between Heeling Sports EMEA and The Sansean Group Limited. (incorporated by reference to Exhibit 10.4 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 filed on May 12, 2008) (The Securities and Exchange Commission has granted confidential treatment for a portion of this document. A complete version of this document has been filed separately with the Securities and Exchange Commission.)

10.12 Consulting Agreement dated as of March 31, 2008, between Heeling Sports EMEA and Achim Lippoth, a German individual. (incorporated by reference to Exhibit 10.5 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 filed on May 12, 2008) (The Securities and Exchange Commission has granted confidential treatment for a portion of this document. A complete version of this document has been filed separately with the Securities and Exchange Commission.)

10.13 Termination Agreement dated as of April 30, 2008, between Heeling Sports Limited and Trotwood Import/Export (the "Distributor"), Trotwood Investments Ltd., the sole owner of the Distributor (the "Shareholder") and David Stanley and Margarete Stanley, the sole owners of the Shareholder. (incorporated by reference to Exhibit 10.6 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 filed on May 12, 2008) (The Securities and Exchange Commission has granted confidential treatment for a portion of this document. A complete version of this document has been filed separately with the Securities and Exchange Commission.)

10.14 Consulting Agreement dated as of April 30, 2008, between Heeling Sports EMEA and Trotwood Investments Ltd. represented by Margarete Stanley. (incorporated by reference to Exhibit 10.7 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2008 filed on May 12, 2008) (The Securities and Exchange Commission has granted confidential treatment for a portion of this document. A complete version of this document has been filed separately with the Securities and Exchange Commission.)

10.15 Consulting Agreement dated as of April 30, 2008, between Heelys, Inc. and Patrick F. Hamner (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on May 2, 2008).*

10.16 Employment Agreement dated as of July 17, 2008, between Heelys, Inc. and Donald K. Carroll (incorporated by reference to Exhibit 10.5 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010 filed on August 13, 2010).*

10.17 Executive Employment Agreement, dated as of August 29, 2008, between Heeling Sports Limited and Lisa K. Peterson (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K/A filed on September 4, 2008).*

10.18 Executive Employment Agreement, dated as of August 29, 2008, between Heeling Sports Limited and John Benton Price (incorporated by reference to Exhibit 10.2 of Registrant's Current Report on Form 8-K/A filed on September 4, 2008).*

10.19 Executive Employment Agreement, dated as of October 28, 2008, between Heeling Sports Limited and William D. Albers (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on October 31, 2008).*

10.20 Executive Employment Agreement, dated as of October 28, 2008, between Heeling Sports Limited and John W. O'Neil (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on October 31, 2008).*

10.21 Severance and General Release Agreement dated as of February 10, 2009, between Donald K. Carroll and Heeling Sports Limited (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on February 10, 2009).*

10.22 Letter of Agreement dated as of February 9, 2009, between Michael W. Hessong and Heelys, Inc. (incorporated by reference to Exhibit 10.2 of Registrant's Current Report on Form 8-K filed on February 10, 2009).*

10.23 Executive Employment Agreement, dated as of July 17, 2009, by and between Heeling Sports Limited and Thomas C. Hansen (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on July 20, 2009).*

10.24 Compromise and Settlement Agreement, effective as of August 21, 2009 (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on September 1, 2009).

10.25 First Amendment to Executive Employment Agreement dated February 18, 2010 (to be effective as of March 1, 2010) by and between John W. O'Neil and Heeling Sports Limited (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on February 18, 2010).*

10.26 Heelys, Inc. 2006 Stock Incentive Plan, as amended and restated effective as of May 20, 2010 (incorporated by reference to Appendix A of the Company's Definitive Schedule 14A, as filed with the Commission on April 23, 2010).*

10.27 Sourcing Agreement dated April 21, 2010, to be effective May 1, 2010, between Heeling Sports Limited and TGB, LLC (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on April 26, 2010).

10.28 Letter from Heelys, Inc. to Craig D. Storey regarding employment terms (incorporated by reference to Exhibit 10.3 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2010 filed on August 13, 2010).*

10.29 Form of Stock Option Agreement to be entered into by the Company with stock option grantees under the Heelys, Inc. 2006 Stock Incentive Plan (incorporated by reference to Exhibit 10.2 of Registrant's Current Report on Form 8-K filed on August 27, 2010).*

10.30 Form of Restricted Stock Unit Award Agreement under the Heelys, Inc. 2006 Stock Incentive Plan (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on November 12, 2010).*

10.31 Summary of terms of 2010 Management Incentive Plan (which plan is not set forth is any formal plan document) (incorporated by reference to Exhibit 10.1 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010 filed on November 12, 2010).*

10.32 Termination Agreement, dated as of February 22, 2011, and effective as of February 28, 2011, by and between Heeling Sports Limited and Privee AG Corporation (incorporated by reference to Exhibit 99.1 to Registrants Current Report on Form 8-K filed on February 24, 2011).

10.33 Summary of terms of Heelys, Inc. 2011 Management Incentive Plan (which plan is not set forth is any formal plan document; incorporated by reference to Exhibit 10.33 to Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed on March 10, 2011).*

10.34 Heelys, Inc. 2012 Management Incentive Plan (incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed on March 20, 2012).*

10.35 Form of Award Agreement under Heelys, Inc. 2012 Management Incentive Plan (incorporated by reference to Exhibit 10.2 to Registrant's Current Report on Form 8-K filed on March 20, 2012).*

10.36 Heelys, Inc. 2012 Long-Term Management Incentive Plan (incorporated by reference to Exhibit 10.3 to Registrant's Current Report on Form 8-K filed on March 20, 2012).*

10.37 Form of Award Agreement under Heelys, Inc. 2012 Long-Term Management Incentive Plan (incorporated by reference to Exhibit 10.4 to Registrant's Current Report on Form 8-K filed on March 20, 2012).*

10.38 Executive Restrictive Covenant and Retention Agreement dated March 16, 2012 by and between Craig D. Story and Heeling Sports Limited (incorporated by reference to Exhibit 10.1 of Registrant's Current Report on Form 8-K filed on March 20, 2012).*

21.1 List of subsidiaries of the Registrant.†

23.1 Consent of Grant Thornton LLP, independent registered public accounting firm.†

31.1	Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 by Thomas C. Hansen, Chief Executive Officer.†
31.2	Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 by Craig D. Storey, Chief Financial Officer.†
32.1	Certification by Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.†
101.INS	Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Management contract or a compensatory plan or arrangement required to be filed as an Exhibit pursuant to Item 15(b) of Form 10-K.

† Filed herewith.

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.

HEELYS, INC.

By: /s/ THOMAS C. HANSEN

Thomas C. Hansen
Chief Executive Officer

Date: March 21, 2012

Pursuant to the requirements 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/ THOMAS C. HANSEN Thomas C. Hansen	Chief Executive Officer and Director (Principal Executive Officer)	March 21, 2012
/s/ CRAIG D. STOREY Craig D. Storey	Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 21, 2012
/s/ GARY L. MARTIN Gary L. Martin	Chairman of the Board	March 21, 2012
/s/ JERRY R. EDWARDS Jerry R. Edwards	Director	March 21, 2012
/s/ PATRICK F. HAMNER Patrick F. Hamner	Director	March 21, 2012
/s/ N. RODERICK MCGEACHY, III N. Roderick McGeachy, III	Director	March 21, 2012
/s/ GLENN M. NEBLETT Glenn M. Neblett	Director	March 21, 2012
/s/ RALPH T. PARKS Ralph T. Parks	Director	March 21, 2012
/s/ RICHARD F. STRUP Richard F. Strup	Director	March 21, 2012

HEELYS, INC.
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Heelys, Inc.

We have audited the accompanying consolidated balance sheets of Heelys, Inc. and subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Heelys, Inc. and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ Grant Thornton LLP

Dallas, Texas
March 21, 2012

HEELYS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and par value data)

	December 31, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 17,925	$ 35,320
Investments	40,469	32,299
Accounts receivable, net of allowances of $391 and $237, respectively	7,077	3,135
Inventories	8,836	6,810
Prepaid expenses and other current assets	1,193	689
Income taxes receivable	133	—
Deferred income taxes	14	8
Total current assets	75,647	78,261
PROPERTY AND EQUIPMENT, net of accumulated depreciation of $1,933 and $1,906, respectively	570	798
PATENTS AND TRADEMARKS, net of accumulated amortization of $1,456 and $1,355, respectively	320	372
INTANGIBLE ASSETS, net of accumulated amortization of $1,091 and $891, respectively	380	689
GOODWILL	1,532	1,568
DEFERRED INCOME TAXES	364	126
TOTAL ASSETS	$ 78,813	$ 81,814
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 2,277	$ 1,089
Accrued liabilities	2,974	1,661
Income taxes payable	-	506
Deferred income taxes	104	18
Total current liabilities	5,355	3,274
LONG TERM LIABILITIES:		
Income taxes payable	660	547
Deferred income taxes	40	2
Other long term liabilities	247	219
TOTAL LIABILITIES	6,302	4,042
COMMITMENTS AND CONTINGENCIES (Note 11)		
STOCKHOLDERS' EQUITY:		
Common stock, $0.001 par value, 75,000,000 shares authorized; 27,571,052 shares issued and outstanding as of December 31, 2011 and 2010	28	28
Additional paid-in capital	66,126	65,691
Retained earnings	6,941	12,541
Accumulated other comprehensive loss	(584)	(488)
Total stockholders' equity	72,511	77,772
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 78,813	$ 81,814

See notes to consolidated financial statements.

HEELYS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Year Ended December 31,	
	2011	2010
NET SALES	$ 32,017	$ 30,436
COST OF SALES	18,697	17,783
GROSS PROFIT	13,320	12,653
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES		
Selling and marketing	8,751	7,291
General and administrative	10,735	10,106
Total selling, general and administrative expenses	19,486	17,397
LOSS FROM OPERATIONS	(6,166)	(4,744)
OTHER (INCOME) EXPENSE		
Interest (income) expense, net	(274)	(355)
Other (income) expense, net	(525)	(818)
Exchange (gain) loss, net	(6)	153
Total other (income) expense, net	(805)	(1,020)
LOSS BEFORE INCOME TAXES	(5,361)	(3,724)
INCOME TAX EXPENSE	239	267
NET LOSS	$ (5,600)	$ (3,991)
LOSS PER SHARE:		
Basic and diluted	$ (0.20)	$ (0.14)
WEIGHTED AVERAGE SHARES OUTSTANDING:		
Basic and diluted	27,571	27,571

See notes to consolidated financial statements.

HEELYS, INC.
CONSOLIDATED STATEMENTS OF
STOCKHOLDERS' EQUITY AND COMPREHENSIVE LOSS
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2011
(in thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount				
BALANCE— January 1, 2010	27,571	$ 28	$ 65,305	$ 16,532	$ (125)	$ 81,740
Comprehensive loss:						
Net loss				(3,991)		(3,991)
Foreign currency translation adjustment					(363)	(363)
Total comprehensive loss						(4,354)
Stock-based compensation expense			386			386
BALANCE— December 31, 2010	27,571	28	65,691	12,541	(488)	77,772
Comprehensive loss:						
Net loss				(5,600)		(5,600)
Foreign currency translation adjustment					(96)	(96)
Total comprehensive loss						(5,696)
Stock-based compensation expense			435			435
BALANCE— December 31, 2011	27,571	$ 28	$ 66,126	$ 6,941	$ (584)	$ 72,511

See notes to consolidated financial statements.

HEELYS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31, 2011	Year Ended December 31, 2010
OPERATING ACTIVITIES:		
Net Loss	$ (5,600)	$ (3,991)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	759	770
Accretion (amortization) of premium (discount) on investments, net	650	485
Accrued interest income	(207)	(167)
Deferred income taxes	(130)	2,992
Stock-based compensation	435	386
Unrealized exchange (gain) loss, net	(12)	48
Loss on disposal of property and equipment	27	29
Inventory impairment charges and reserves	1,246	352
Changes in operating assets and liabilities:		
Accounts receivable	(4,040)	2,344
Inventories	(3,337)	(1,298)
Prepaid expenses and other current assets	(279)	210
Accounts payable	1,275	(452)
Accrued liabilities	1,514	(641)
Income taxes payable/receivable	(552)	1,644
Net cash (used in) provided by operating activities	(8,251)	2,711
INVESTING ACTIVITIES:		
Purchases of investments	(57,691)	(44,362)
Proceeds from maturities of investments	48,872	38,700
Purchases of equipment	(125)	(306)
Increase in patents and trademarks	(89)	(162)
Net cash used in investing activities	(9,033)	(6,130)
FINANCING ACTIVITIES:		
Payment for previously acquired goodwill and intangible assets	(143)	(575)
Net cash used in financing activities	(143)	(575)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	32	(56)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(17,395)	(4,050)
CASH AND CASH EQUIVALENTS, beginning of year	35,320	39,370
CASH AND CASH EQUIVALENTS, end of year	$ 17,925	$ 35,320
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Income taxes	$ 957	$ 1,269
Interest	$ -	$ 242

See notes to consolidated financial statements.

HEELYS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS DESCRIPTION AND BASIS OF PRESENTATION

Business Description—Heelys, Inc. and subsidiaries (the "Company" or "Heelys") designs, markets and distributes innovative, action sports-inspired products primarily under the HEELYS brand targeted to the youth market. The primary product, HEELYS-wheeled footwear, is patented, dual-purpose footwear that incorporates a stealth, removable wheel in the heel. HEELYS are distributed directly to retail stores in the United States and certain international countries, and through international wholesale distributors.

The Company initially incorporated as Heeling, Inc. in Nevada in 2000. The Company was reincorporated in Delaware in August 2006 and changed its name to Heelys, Inc. Through its general and limited partner interests, Heelys, Inc. owns 100% of Heeling Sports Limited, a Texas limited partnership, which was formed in May 2000.

In February 2008, the Company formed Heeling Sports EMEA SPRL, a Belgium corporation and indirect wholly-owned subsidiary of the Company, with offices in Brussels, and branch offices in Germany and France, primarily to manage the Company's European operations. As part of an initiative to improve efficiency and reduce costs, the Company began taking steps in the first quarter of 2012 to close its office in Brussels and transition the business operations conducted through that office to its French and German offices.

In February 2011, the Company formed Heeling Sports Japan K.K., a Japanese corporation and indirect wholly-owned subsidiary of the Company with offices in Tokyo, to manage its operations in Japan and to take over distribution in that country effective March 1, 2011.

Consolidated Financial Statements—The consolidated financial statements include the accounts of Heelys, Inc. and its subsidiaries. All intercompany balances and transactions are eliminated in consolidation.

Use of Estimates—The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses for the period. Management's significant estimates are as follows: allowances for estimated customer returns, marketing discretionary funds and doubtful accounts; assessment of lower of cost or market on inventory; income taxes including deferred taxes and uncertain tax positions; and legal reserves for current pending claims (if any) and estimated incurred-but-not-reported claims. Actual results could differ from these estimates and the differences could be material. Differences are reported in the period in which they become known.

Foreign Currency Translation—The U.S. dollar is the Company's reporting currency. Assets and liabilities of foreign operations which are denominated in a functional currency other than the U.S. dollar are translated at the rate of exchange at the balance sheet date. Revenues and expenses are translated at the average rate of exchange during the applicable period. Adjustments resulting from translating foreign functional currency financial statements into U.S. dollars are included in the foreign currency translation adjustment, a component of accumulated other comprehensive loss in stockholders' equity.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fair Value Measurements—The Company uses a hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach, and cost approach).

The levels of hierarchy are described below:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.

- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

- Level 3: Unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. Financial assets and liabilities are classified in their entirety based on the most stringent level of input that is significant to the fair value measurement.

Refer to Note 6 for discussion regarding fair value of investments. All other financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their liquid and short-term nature.

Accounts Receivable—Accounts receivable are stated net of estimated allowances for uncollectible accounts, customer returns, defective merchandise, co-op advertising and marketing discretionary funds. Accounts are not collateralized and do not bear interest. In determining the amount of the allowances for accounts receivable, the Company considers, among other things, historical experience. If the Company determines a smaller or larger allowance was appropriate, these changes in estimates are recorded in the period in which such determination is made. After all collection efforts are exhausted and an account is deemed uncollectible, it is written off against the allowance for doubtful accounts.

Inventories—Inventories are purchased as finished goods from independent manufacturers and are stated at the lower of cost or market. Inventories are valued on a first-in first-out ("FIFO") basis. Inventory costs include inbound freight. Inventory quantities are regularly reviewed and provisions for excess or obsolete inventory are recorded primarily based on the forecast of future demand and market conditions. Ongoing estimates are made relating to the net realizable value of inventories. If the estimated net realizable value of inventory is less than the cost, a write-down equal to the difference between the cost of the inventory and the estimated net realizable value is recorded. If changes in market conditions result in reductions in the estimated net realizable value of inventory below previous estimates, an increase in the write-down is recorded in the period in which such a determination was made. During 2011 and 2010, the Company charged cost of sales $1.2 million and $352,000, respectively, in order to properly state inventories at lower of cost or market. Inventories at December 31, 2011 and 2010 include $579,000 and $398,000, respectively, of packaging and other raw materials directly attributable to the Company's Nano™ inline footboard.

Goodwill and Intangible Assets—Goodwill is not amortized but is instead measured for impairment at least annually, or when events indicate that impairment might exist. The Company compares the estimated fair value of the reporting unit to the carrying value. The Company's estimate of fair value utilized in goodwill tests is based upon a number of factors, including assumptions about the expected future operating performance of the Company's reporting units. Estimates may change in future periods due to, among other things, the expected future operating performance of the Company's reporting units, technological changes, economic conditions, changes to the Company's business operations or inability to meet business plans. Such changes may result in impairment charges recorded in future periods. Any impairment charge related to goodwill would be classified as a separate line item on the consolidated statement of operations for amounts necessary to reduce the carrying value of the asset to fair value. The Company performs its annual impairment test during the fourth quarter. Intangible assets that are determined to have definite lives are amortized over their useful lives and are measured for impairment only when events or circumstances indicate the carrying value may be impaired. In these cases, the Company estimates the future undiscounted cash flows to be derived from the asset to

determine whether or not a potential impairment exists. If the carrying value exceeds the Company's estimate of future undiscounted cash flows, the Company then calculates the impairment as the excess of the carrying value of the asset over the estimate of its fair value. There were no impairments identified in either of the periods presented.

Long-Lived Assets—The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets held and used is generally measured by a comparison of the carrying amount of an asset to undiscounted pretax future net cash flows expected to be generated by that asset. An impairment loss is recognized if the estimated undiscounted future cash flows are less than the carrying value of the related assets. There were no impairments identified in either of the periods presented.

Income Taxes—The Company accounts for income taxes using the asset and liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of other assets and liabilities. The Company evaluates its ability to realize the tax benefits associated with deferred tax assets and a valuation allowance is established unless management determines that it is more likely than not that the Company will ultimately realize the tax benefit associated with a deferred tax asset. The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by a taxing authority, based on the technical merits of the position. The amount recognized in the financial statements from an uncertain tax position is measured based on the largest amount of benefit that has a greater than 50% likelihood of being realized upon ultimate resolution. These liabilities (for uncertain tax positions) are included in income taxes payable in the consolidated balance sheet. Related accrued interest is included in interest expense and related penalties are included in general and administrative expense. Accrued interest and penalties are included within the related income tax liability line in the consolidated balance sheet.

Revenue Recognition—Revenues are recognized when merchandise is shipped, title passes to the customer, the customer assumes risk of loss, the collection of relevant receivables is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. Title passes upon shipment or upon receipt by the customer depending on the agreement with the customer. The Company records reductions to revenue for customer discounts, marketing discretionary funds, estimated returns and other allowances, including permitted returns of damaged or defective merchandise. The Company recorded total reductions to revenue for these allowances of $105,000 and $585,000 during 2011 and 2010, respectively.

Shipping and Handling Costs—Shipping and handling costs that are not directly attributable to the procurement of inventory are expensed as incurred and are included in general and administrative expense. These costs include costs that the Company incurs to ship product to its customers, storage charges and rent expense for warehouse facilities, warehouse labor, warehouse and packing materials and deprecation of warehouse equipment. Shipping and handling costs included in general and administrative expense were $2.5 million and $2.0 million during 2011 and 2010, respectively. Shipping and handling costs billed to customers are included in net sales, and were $92,000 and $79,000 during 2011 and 2010, respectively. Shipping and handling costs that are directly attributable to the procurement of inventory are recognized in cost of sales when such inventory is sold.

Advertising Costs—Advertising production costs are expensed the first time the advertisement is run. Media (TV, radio and print) placement costs are expensed in the month the advertising appears or is aired. Through cooperative advertising programs, the Company reimburses its retail customers for certain of their costs of advertising the Company's products. The Company records these costs in selling and marketing expense at the point in time when it is obligated to its customers for the costs, which is when the related revenues are recognized. This obligation may arise prior to the related advertisement being run. Total advertising and promotion expenses were $4.2 million and $4.0 million during 2011 and 2010, respectively. Prepaid advertising and promotion expenses recorded in prepaid expense totaled $30,000 and $107,000 at December 31, 2011 and 2010, respectively.

Stock-Based Compensation—Stock-based compensation expense is measured at the grant date based on the estimated fair value of the award, and is recognized as expense over the requisite service period. Fair value of stock option awards is estimated using a Black-Scholes option pricing model. Fair value of restricted stock unit awards is based on the closing trade price of the Company's common stock on the date of grant. Stock-based compensation is recognized using the straight-line method over the period during which the employee is required to provide service in exchange for the award. No compensation expense is recognized for awards for which the employee does not render the required service. If the requisite service is not provided, previously recognized compensation expense is reversed. The total amount of compensation expense attributable to restricted stock unit awards (designated as performance awards) is based upon the estimated number of restricted stock units expected to be earned. This estimate is reassessed at each reporting period and the total amount of compensation expense to be recognized is adjusted accordingly.

Insurance—The Company's insurance retention for general liability claims is $50,000 per claim. An estimated liability is provided for current pending claims (if any) and estimated incurred-but-not-reported claims due to this retention risk. A liability is accrued by a charge to income if it is probable that a liability has been incurred at the date of the financial statements, and the amount of loss can be reasonably estimated. A liability for estimated claims in the amount of $150,000 and $160,000 as of December 31, 2011 and 2010, respectively, is reflected in the balance sheet as an accrued liability. Effective January 1, 2012, the Company's insurance retention for general liability claims will be $25,000 per occurrence with a maximum out-of-pocket of $500,000 per year.

Foreign Currency Transactions—Gains and losses generated by transactions denominated in a currency different from the functional currency of the applicable entity are recorded in other income and expense in the period in which they occur. The Company recognized a $6,000 net gain on foreign currency transactions in 2011, compared to a net loss of $153,000 in 2010.

3. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, to make the presentation of items within other comprehensive income ("OCI") more prominent. The new standard will require companies to present items of net income, items of OCI and total comprehensive income in one continuous statement or two separate consecutive statements, and companies will no longer be allowed to present items of OCI in the statement of stockholders' equity. This new standard is effective for the Company beginning January 1, 2012, with early adoption permitted. The adoption of this new standard may change the order in which certain financial statements are presented and provide additional detail in those financial statements when applicable, but will not have any other impact on the Company's financial statements.

In September 2011, FASB issued ASU 2011-08, Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment, which amends current guidance to simplify how entities test goodwill for impairment. The amendments permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. Under this amendment, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. This pronouncement is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company does not expect the adoption of this new pronouncement to have a material effect on its consolidated financial statements.

4. LOSS PER SHARE

Basic loss per common share is calculated by dividing net loss available to common stockholders for the period by the weighted-average number of common shares outstanding during the period. Diluted loss per share reflects the effects of potentially dilutive securities that could share in the loss of the Company. A reconciliation

of the numerator and denominator used in the calculation of basic and diluted loss per share is as follows (in thousands):

	Year Ended December 31, 2011	Year Ended December 31, 2010
Numerator— net loss available to common stockholders	$ (5,600)	$ (3,991)
Denominator:		
Weighted average common stock outstanding for basic loss per share	27,571	27,571
Effect of dilutive securities:		
Stock options	–	–
Restricted stock units	–	–
Adjusted weighted average common stock and assumed conversions for diluted loss per share	27,571	27,571

Stock options to purchase approximately 1.5 million shares of common stock and restricted stock units convertible into approximately 779,000 shares of common stock were not included in the computation of diluted loss per share for the year ended December 31, 2011, because the effect of their inclusion would be anti-dilutive. Stock options to purchase approximately 1.6 million shares of common stock and restricted stock units convertible into approximately 190,000 shares of common stock were not included in the computation of diluted loss per share for the year ended December 31, 2010, because the effect of their inclusion would be anti-dilutive.

5. CASH EQUIVALENTS

Cash equivalents consist of highly liquid investments with original maturity dates of three months or less when purchased. Cash equivalents at December 31, 2011 and 2010 include investments in the Fidelity Money Market Fund in the amount of $4.9 million and $18.9 million, respectively. Investments in the Fidelity Money Market Fund are valued using observable inputs (Level 1 fair value hierarchy).

6. INVESTMENTS

Investments consist of the following:

	As of December 31, 2011				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses(1a)	Aggregate Fair Value(2)	Maturities
	(In thousands, except table notes)				
Current held-to-maturity securities					
Certificate of deposit(3)	$ 500	$ —	$ —	$ 500	Feb-2012
Commercial paper	11,472	—	(8)	11,464	Jan-2012 thru Oct-2012
Corporate bonds	9,436	—	(30)	9,406	Jun-2012 thru Sep-2012
Municipal bonds	19,061	—	(41)	19,020	Mar-2012 thru Oct-2012
Total current held-to-maturity securities	$ 40,469	$ —	$ (79)	$ 40,390	

	As of December 31, 2010				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses(1b)	Aggregate Fair Value(2)	Maturities
	(In thousands, except table notes)				
Current held-to-maturity securities					
Certificate of deposit(3)	$ 500	$ -	$ -	$ 500	May-2011
Commercial paper...	12,462	3	(4)	12,461	Jan-2011 thru Oct-2011
Corporate bonds	13,302	15	(14)	13,303	Jan-2011 thru Nov-2011
Municipal bonds	6,035	-	(11)	6,024	Jun-2011 thru Nov-2011
Total current held-to-maturity securities .	$ 32,299	$ 18	$ (29)	$ 32,288	

(1a) No investments outstanding as of December 31, 2011 have had continuous unrealized loss positions longer than 12 months. All investments that matured during the year ended December 31, 2011 matured at their full face amounts.

(1b) One of the Company's investments (a municipal bond), outstanding as of December 31, 2010, had been in an unrealized loss position (fair value less than book value) since its acquisition in December 2009. The Company considered the facts and circumstances of this investment including the severity of loss ($9,000 at December 31, 2010), the credit quality rating (A+ Moody's rating) and length of time to maturity (investment matured July 1, 2011) and determined that no adjustment was necessary to recognize that loss. This investment matured at its full face amount. No other investments, outstanding as of December 31, 2010, had continuous unrealized loss positions longer than 12 months. All investments that matured during the year ended December 31, 2011 matured at their full face amounts.

(2) Aggregate fair values for commercial paper and bonds were determined using a third-party pricing service. This third-party pricing service uses the market approach to value these investments (Level 2 fair value hierarchy).

(3) In May 2010 the Company purchased a $500,000 certificate of deposit as collateral for a revolving credit facility that the Company entered into with a local bank for the purpose of issuing letters of credit to secure payment to one of its foreign manufacturers. The revolving credit facility was no longer required and was closed, and the certificate of deposit matured, during the second quarter of 2011. A certificate of deposit in the same amount was subsequently purchased.

All investments as of December 31, 2011, and as of December 31, 2010, are classified as held-to-maturity since the Company has the intent and ability to hold these investments to maturity. Investments in debt securities (commercial paper, municipal bonds and corporate bonds) are reported at cost, adjusted for premiums and discounts that are recognized in interest income, using a method that approximates the effective interest method, over the period to maturity.

The fair values of these investments are determined using significant observable inputs other than quoted prices in an active market for the investment (Level 2 fair value hierarchy). The Company determines the fair value of its investments using a pricing service provided by BOSC, Inc., a subsidiary of BOK Financial Corporation. Investments are reviewed quarterly for possible other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as the severity of loss, the length of time the fair value has been below cost, the expectation for that investment's performance, the creditworthiness of the issuer and the length of time to maturity. No impairments have been recognized.

The Company considers as current assets those investments which will mature in the next 12 months. The remaining investments are considered non-current.

7. CONCENTRATION OF RISK

The Company maintains substantially all of its cash and cash equivalents in financial institutions in amounts that exceed federally insured limits or in international jurisdictions where either insurance is not provided or in amounts that exceed amounts guaranteed by the local government or other governmental agencies. Investments in the Fidelity Money Market Fund are not insured. The Company has not experienced any losses with regards to its cash and cash equivalents and believes it is not exposed to significant credit risk.

The Company invests a portion of its cash in fully insured certificates of deposit and in debt instruments of corporations and municipalities with strong credit ratings.

The Company considers its concentration risk related to accounts receivable to be mitigated by the Company's credit policy, the significance of outstanding balances owed by each individual customer at any point in time and the geographic dispersion of these customers.

The Company outsources all of its manufacturing to a small number of independent manufacturers. Establishing replacement sources could require significant additional time and expense.

8. PROPERTY AND EQUIPMENT

Property and equipment include the following (in thousands):

	Estimated useful lives	December 31, 2011	December 31, 2010
Leasehold improvements	1 - 10 years	$ 510	$ 490
Furniture and fixtures	7 years	177	178
Computer equipment (including software)	3 - 5 years	538	780
Equipment	5 years	139	126
Product molds and designs	2 years	1,139	1,130
Total		2,503	2,704
Less accumulated depreciation and amortization		(1,933)	(1,906)
Property and equipment—net		$ 570	$ 798

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are provided using the straight-line method over the estimated useful life of the asset. Leasehold improvements are amortized over their estimated useful lives or the lease term, whichever is shorter.

Depreciation expense related to property and equipment was $312,000 and $319,000 in 2011 and 2010, respectively.

9. INTANGIBLE ASSETS AND GOODWILL

Patents and trademarks include the following (in thousands):

	December 31, 2011	December 31, 2010
Patents	$ 1,438	$ 1,421
Trademarks	313	281
Other	25	25
Total	1,776	1,727
Less accumulated amortization	(1,456)	(1,355)
Patents and trademarks—net	$ 320	$ 372

Patents and trademarks are stated at cost less accumulated amortization. Amortization is provided using the straight-line method over the estimated useful lives of five years. Losses on disposal of patents and trademarks are included in general and administrative expense.

Amortization expense related to patents and trademarks was $133,000 and $134,000 in 2011 and 2010, respectively. Amortization expense from 2012 through 2016 is expected to be $113,000, $92,000, $69,000, $36,000 and $9,000, respectively.

During fiscal year 2008, the Company agreed to purchase a portion of the business operations, certain assets, and retain employees on a contractual basis of two of its former distributors in Germany and France. The primary assets acquired as a result of the termination of these distributors were the customer lists and goodwill. In addition, both of these former distributors agreed to not compete with the Company for a limited period of time.

Intangible assets include the following (in thousands):

	December 31, 2011	December 31, 2010
Non-compete agreements	$ 155	$ 233
Customer lists	1,316	1,347
Total	1,471	1,580
Less accumulated amortization	(1,091)	(891)
Intangible assets—net	$ 380	$ 689

Non-compete agreements are amortized over 2 to 5 years, and customer lists are amortized over 5 years. Amortization expense related to non-compete agreements and customer lists was $314,000 and $317,000 in 2011 and 2010, respectively. Amortization expense from 2012 through 2013 is expected to be $294,000 and $86,000, respectively. These assets will be fully amortized in 2013.

Goodwill includes the following (in thousands):

	December 31, 2011	December 31, 2010
Goodwill	$ 1,532	$ 1,568

Customer lists and goodwill are intangible assets of the Company's Belgian subsidiary whose functional currency is the Euro. Assets and liabilities of foreign operations which are denominated in a functional currency other than the U.S. dollar (the reporting currency) are translated at the rate of exchange as of the applicable balance sheet date. As a result, the U.S. dollar value of these intangibles is impacted by the fluctuation in the exchange rate. The only changes to the customer lists and goodwill intangibles during the fiscal year ended December 31, 2011 were the result of the difference in the exchange rate as of December 31, 2011 and December 31, 2010.

10. ACCRUED LIABILITIES

Accrued expenses consist of the following (in thousands):

	December 31, 2011	December 31, 2010
Professional fees	$ 77	$ 91
Payments due - termination of distributorship agreements	67	217
Accrued taxes payable	124	89
Customer credits and prepayments	199	242
Payroll and payroll related costs	488	320
Inventory and related costs	1,257	150
Commissions	295	185
Insurance	150	160
Other	317	207
Total accrued liabilities	$ 2,974	$ 1,661

Customer credits includes amounts due customers in excess of amounts owed to the Company, including estimated credits due customers for estimated returns and co-op advertising and marketing allowances.

11. COMMITMENTS AND CONTINGENCIES

Leases—Effective February 1, 2005, the Company entered into an operating lease whereby the Company leases office and warehouse space in Carrollton, Texas for 10 years with two five year renewal options. On February 27, 2006, the Company signed an amendment to this lease for additional warehouse space for the duration of the lease term. The information in the table below does not include renewal options.

Effective May 1, 2008, Heeling Sports EMEA entered into an operating lease for office space in Brussels, Belgium for nine years with the option to terminate the lease at the end of each three year period. This lease was not terminated at the end of the first three year period. The information in the table below assumes that this lease will not be renewed after the second three year period. Payments under this lease agreement are made in Euro. Future minimum payments, included in the table below, have been estimated using the currency exchange rate as of December 31, 2011. While the Company has begun taking steps in the first quarter of 2012 to close its Belgian office, and transition the business operations conducted through that office to its French and German offices, the Company has not terminated the operating lease for its Belgian office.

Effective April 1, 2008, Heeling Sports EMEA entered into an operating lease for office space in Munich, Germany for three years with an automatic renewal at the end of the initial three year lease unless six months notice is provided. This lease was renewed for a period of one year from April 1, 2011 through March 31, 2012, and has been renewed for a period of one year from April 1, 2012 through March 31, 2013. The information in the table below does not include additional lease extensions. Payments under this lease agreement are made in Euro. Future minimum payments, included in the table below, have been estimated using the currency exchange rate as of December 31, 2011.

Effective May 1, 2008, Heeling Sports EMEA entered into an operating lease for office space in Annecy, France for nine years with the option to terminate the lease at the end of each three year period. This lease was not terminated at the end of the original three year period. The information in the table below assumes this lease will not be renewed after the second three year period. Payments under this lease agreement are made in Euro. Future minimum payments, included in the table below, have been estimated using the currency exchange rate as of December 31, 2011.

Effective March 1, 2011, Heeling Sports Japan entered into an operating lease for office space in Tokyo, Japan for two years with an automatic renewal at the end of the initial two year lease unless six months notice is provided. The information in the table below does not include additional lease extensions. Payments under this lease agreement are made in Japanese Yen. Future minimum payments, included in the table below, have been estimated using the currency exchange rate as of December 31, 2011.

Future minimum rental payments under these agreements are as follows (in thousands):

Years Ending December 31,	
2012	$ 382
2013	286
2014	227
2015	128
2016	-
Thereafter	-
	$ 1,023

Rent expense for leased office space, and warehouse space in Carrollton, Texas, was $397,000 and $369,000 for 2011 and 2010, respectively. Rent expense for additional and temporary warehouse space was $67,000 and $3,700 for 2011 and 2010, respectively.

Third-Party Distribution Facility (Belgium)—The Company uses a third-party distribution facility in Belgium. The Company pays this third-party distributor fees and charges for services including storage, handling, processing and packing materials. These fees and charges are activity based and therefore fluctuate and as a result related future obligations cannot be quantified. This agreement is for one year with automatic one year renewal terms. The Company expensed $1.6 million and $1.3 million related to this third-party distribution facility in 2011 and 2010, respectively. These costs are included in general and administrative expense.

Third-Party Distribution Facility (Japan)—In March 2011, the Company began to use a third-party distribution facility in Japan. The Company pays this third-party distributor fees and charges for services including storage, handling, processing and packing materials. These fees and charges are activity based and therefore fluctuate and as a result related future obligations cannot be quantified. This agreement is for one year with automatic one year renewal terms. The Company expensed $191,000 related to this third-party distribution facility 2011. These costs are included in general and administrative expense.

Termination of Distributorship Agreements—During fiscal year 2008, the Company agreed to purchase a portion of the business operations, certain assets, and retain employees on a contractual basis of two of its former distributors in Germany and France. The details related to these activities are outlined below.

Effective March 31, 2008, the Company entered into agreements to terminate its arrangement regarding the distribution of Heelys-branded footwear and products in Germany and Austria, allowing the Company, through its Belgian subsidiary, to market its products directly in such countries. This included a Termination Agreement (the "Termination Agreement") among the Company, The Territory Distribution GmbH (the "Distributor"), and Achim Lippoth, the sole owner of the Distributor ("Lippoth"), pursuant to which, among other things, a prior Distributor Agreement between the Company and the Distributor was terminated, the Company agreed to purchase from the Distributor all of the Distributor's inventory of unsold Heelys products and other specified assets for the Distributor's cost, all of the unshipped orders for Heelys products on the Distributor's order book as of March 31, 2008 for a price equal to the Distributor's net wholesale margin on such unshipped orders (which is to be paid on or before the end of the month following the Company's receipt of payment for the Heelys products shipped in response to such unshipped orders), and the Distributor and Lippoth agreed, until March 31, 2010, not to compete with the Company relating to the Company's products anywhere in the world. In connection with the Termination Agreement, the Company entered into two consulting agreements, one with The Sansean Group Limited ("Sansean"), and one with Lippoth, pursuant to which, among other things,

Sansean and Lippoth agreed to perform certain consulting services and the Company agreed to pay Sansean and Lippoth consulting fees as set forth in their respective consulting agreements. Payments under these agreements are to be made in Euro.

Effective April 30, 2008, the Company entered into agreements to terminate its current arrangement regarding the distribution of Heelys-branded footwear and products in France, Monaco and Andorra, allowing the Company, through its Belgian subsidiary, to market its products directly in such countries. This included a Termination Agreement (the "Termination Agreement") among the Company, Trotwood Import/Export (the "Distributor"), Trotwood Investments Ltd., the sole owner of the Distributor ("TIL"), and David Stanley ("D. Stanley") and Margarete Stanley ("M. Stanley"), pursuant to which, among other things, a prior International Distributor Agreement between the Company and the Distributor was terminated, the Company agreed to purchase from the Distributor all of the Distributor's inventory of unsold Heelys products for the Distributor's cost of such products, the Distributor's order books relating to Heelys products at the value on Distributor's books and certain other incidental assets of the Distributor related to its distribution operations as described in the Termination Agreement (the Company agreed to pay Distributor for such items on or before May 16, 2008), the Company agreed to purchase from the Distributor all of the unshipped orders for Heelys products on the Distributor's order book as of April 30, 2008 that are not novated to the Company or one of its affiliates for a price equal to the Distributor's net wholesale margin on such unshipped orders (which is to be paid on or before the end of the month following the Company's receipt of payment for the Heelys products shipped in response to such unshipped orders). In addition, the Distributor, TIL, D. Stanley and M. Stanley agreed, until April 30, 2012, not to compete with the Company relating to the Company's products anywhere in the world and the Company agreed to pay Distributor an additional amount set forth in the Termination Agreement for each pair of Heelys branded footwear sold by the Company or its affiliates in France, Monaco and Andorra. In connection with the Termination Agreement, the Company entered into a Consulting Agreement with TIL pursuant to which, among other things, TIL agreed to perform certain consulting services and the Company agreed to pay TIL consulting fees as set forth in such consulting agreement. Payments under these agreements were made in Euro.

The primary assets acquired as a result of the termination of these distributorship agreements were the customer lists and goodwill. In addition, both of these former distributors agreed to not compete with the Company for a limited period of time. The fair value and the total amount paid for the acquired assets was $3.7 million (2.4 million Euro) based upon the amount at which the assets could be bought or sold in a current transaction between willing parties. As a result, the Company recorded goodwill of $1.9 million (1.2 million Euro) and intangibles (acquired customer relationships and non-compete) of $1.8 million (1.2 million Euro). As of December 31, 2011, the Company has paid $3.2 million (2.2 million Euro) for these acquired assets with the balance of $214,000 (166,000 Euro) to be paid out over time in accordance with the terms of the agreements. As of December 31, 2011, $121,000 is recorded as other long term liability and $93,000 is recorded as a current liability.

Purchase Commitments—The Company had open inventory purchase commitments of $3.8 million at December 31, 2011.

Sourcing Agreement—On April 21, 2010 (effective as of May 1, 2010), the Company entered into an agreement with TGB, LLC, a New Jersey limited liability company ("TGB"), under which TGB acted as the exclusive sourcer of the Company's products (the "Sourcing Agreement"). In April 2011, the Company reached an agreement with TGB to terminate the Sourcing Agreement with TGB. From and after the termination of that Sourcing Agreement, the Company was not required to (and did not) purchase any other products from TGB under that Sourcing Agreement and, instead purchased products directly from the Company's independent manufacturers.

Revolving Credit Facility— In June 2010, the Company entered into a $500,000 revolving credit facility with a local bank for the purpose of issuing letters of credit to secure payment to one of its foreign manufacturers. This revolving credit facility was no longer required and was closed during the second quarter of 2011.

Legal Proceedings–Due to the nature of the Company's products, from time to time the Company has to defend against personal injury and product liability claims arising out of personal injuries that allegedly are suffered using the Company's products. To date, none of these claims has had a material adverse effect on the Company. The Company is also engaged in various claims and legal proceedings relating to intellectual property matters, especially in connection with enforcing the Company's intellectual property rights against the various third parties importing and selling knockoff products domestically and internationally. Often, such legal proceedings result in counterclaims against the Company that the Company must defend. The Company believes that none of the pending personal injury, product liability or intellectual property legal matters will have a material adverse effect upon the Company's financial position, cash flows or results of operations. Litigation settlement payments related to intellectual property legal matters (whether received by the Company or paid by the Company) are reported as other income (expense) in the Company's statement of operations. Legal fees related to intellectual property matters and associated enforcement are included in general and administrative expenses. The Company recognized $575,000 and $822,000 in other income resulting from litigation settlement payments in the Company's favor in 2011 and 2010, respectively, which included a settlement of a potential patent and trademark lawsuit in the amount of $375,000 during the third quarter of 2011 and $750,000 during the second quarter of 2010 for the settlement of another potential patent and trademark lawsuit.

12. INCOME TAXES

Components of income taxes were as follows (in thousands):

	December 31,	
	2011	2010
Current expense (benefit):		
Federal	$ -	$ (3,112)
State	-	(37)
Foreign	369	424
Total current expense (benefit), net	369	(2,725)
Deferred expense (benefit):		
Federal	-	3,094
State	-	-
Foreign	(130)	(102)
Total deferred expense (benefit), net	(130)	2,992
Total income tax expense (benefit), net	$ 239	$ 267

A reconciliation of income tax computed at the U.S. federal statutory income tax rate of 35% to the provision for income taxes is as follows (in thousands):

	December 31,	
	2011	2010
Tax at statutory rate	$ (1,876)	$ (1,294)
Non-deductible incentive stock option expense	54	61
Non-deductible penalties	33	(58)
State income taxes net of federal benefit	-	2
Increase in valuation allowance	2,179	1,463
Increase in unrecognized tax benefits net of indirect benefits	89	43
Other	(240)	50
Total income tax expense (benefit), net	$ 239	$ 267

Deferred income taxes reflect the tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. The tax effects of significant items included in the Company's net deferred tax benefits (expense) were as follows (in thousands):

	December 31,	
	2011	2010
Current tax assets (liabilities):		
Allowance for bad debts	$ 44	$ 46
Inventories	89	94
Prepaid expenses	(114)	(37)
Accrued expenses	116	90
Other	93	37
Total net current deferred tax assets (liabilities)	228	230
Less: Valuation allowance	(318)	(240)
Net current deferred tax assets (liabilities)	(90)	(10)
Long-term tax assets (liabilities):		
Fixed assets and intangibles	273	243
Tax method change	-	(30)
Net operating loss carryovers	3,598	1,737
State income taxes	136	128
Unremitted earnings foreign subsidiary	-	(48)
Share-based compensation	606	516
Other	357	109
Total net long-term deferred tax assets (liabilities)	4,970	2,655
Less: Valuation allowance	(4,646)	(2,531)
Net long-term deferred tax assets (liabilities)	324	124
Total deferred tax assets (net of deferred liabilities)	$ 234	$ 114

During the year ended December 31, 2011, the valuation allowance increased by approximately $2.2 million as the Company believes that it is more likely than not that certain U.S. and Japanese deferred tax assets will not be realized as of December 31, 2011. As of December 31, 2011, a valuation allowance of $5.0 million had been recognized for deferred income taxes that may not be realized by the Company in future periods. As of December 31, 2011, the Company has a domestic net operating loss carryover of $7.9 million that will begin to expire in 2030. The Company also has foreign net operating loss carryovers of $2.3 million that will begin to expire in 2018.

A deferred tax liability has been set up for income taxes which may become payable upon distribution of earnings of the Company's Belgian subsidiary. The estimated amount of tax that might be payable with regard to any distribution of foreign subsidiary earnings is reported net of foreign taxes paid which are creditable against domestic tax liability. The Company does not permanently reinvest its foreign subsidiary's earnings. Prior to 2009, the Company's Belgian subsidiary incurred losses and as such no deferred taxes were recorded. As a result of the 2009 earnings in its Belgian subsidiary, the Company has recorded a deferred tax liability. The Company continually evaluates its assertion and will make a change as business needs change.

A reconciliation of the consolidated liability for gross unrecognized income tax benefits (excluding penalties and interest) from January 1, 2010 to December 31, 2011, is as follows (in thousands):

	2011	2010
Balance at beginning of year	$ 365	$ 1,257
Decreases in prior year tax positions	-	(40)
Increases in prior year tax positions	-	84
Increases in current year tax positions	89	-
Settlements with taxing authorities	-	(936)
Lapse of statute of limitations	-	-
Balance at end of year	$ 454	$ 365

If the Company were to prevail on all unrecognized tax benefits recorded, approximately $282,000 of the unrecognized tax benefits (excluding accrued interest and penalties) at December 31, 2011 would benefit the effective tax rate. Liabilities for unrecognized tax benefits are included in income taxes payable in the consolidated balance sheet. All unrecognized tax benefits have been classified as noncurrent liabilities.

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties related to tax liabilities in general and administrative expense. During the years ended December 31, 2011 and 2010, the Company recognized approximately $41,000 and $35,000 in interest and penalties, respectively. The Company has accrued $206,000 and $181,000 for interest and penalties at December 31, 2011 and 2010, respectively. Accrued interest and penalties are included within the related income tax liability line in the consolidated balance sheet. All unrecognized tax benefits have been classified as non-current liabilities.

The statute of limitation remains open for the Company's consolidated federal income tax returns for the tax years ended December 31, 2006 forward. The statute of limitations remains open for income tax returns filed in Belgium, Germany and France for tax years ended December 31, 2008 forward. State statutes are open for various years, depending on the jurisdiction. The Company’s federal income tax return for the year ended December 31, 2007 was reviewed by the Internal Revenue Service. There were no adjustments to that return as a result of the review. There are no income tax examinations currently in process.

13. STOCK-BASED COMPENSATION

In June 2006, the Company adopted the 2006 Stock Incentive Plan which was amended and restated on May 20, 2010 (the “2006 Plan”). The purpose of the 2006 Plan is to provide certain key employees, non-employee directors and consultants with a proprietary interest in the Company through the granting of stock options and awards of restricted stock units.

The Company has reserved 2,972,725 shares of common stock subject to the 2006 Plan and as of December 31, 2011 had 358,546 shares remaining available that may be granted to employees, consultants and nonemployee directors of the Company in the future. The 2006 Plan is administered by the compensation committee of the Company's board of directors, which selects the persons to whom awards will be granted, determines the number of shares to be subject to each grant, and prescribes the other terms and conditions of each grant, including performance criteria, the type of consideration to be paid to the Company upon exercise and the vesting schedule. Unless specifically provided otherwise in an individual award agreement under the 2006 Plan, if a change in control of the Company, as defined by the 2006 Plan, occurs, (a) all of the options issued under the 2006 Plan will accelerate and become fully vested and exercisable and (b) the forfeiture restrictions under the restricted unit award agreement may lapse and the unvested restricted stock units may become vested and released from the forfeiture restrictions under such award only if the change in control constitutes a “change in control” within the meaning of Section 409A of the Internal Revenue Code of 1986, as amended.

Stock Options

Stock option awards are generally granted with an exercise price equal to the market price of the Company's stock at the date of grant, generally vest over four years of continuous service and have a 10-year contractual life. Stock-based compensation is based on the estimated fair value of the award on the date of grant. The Company recognizes this expense using the straight-line method over the period during which an employee is required to provide service in exchange for the award—the requisite service period. No compensation expense is recognized for stock options for which employees do not, or are not expected to, render the requisite service.

The following summarizes stock option grants made by the Company during 2010 and 2011:

Date of Grant	Number of Shares Granted	Exercise Price
March 2010	40,000	$ 2.47
August 2010	82,000	$ 2.36
December 2010	20,000	$ 3.37
February 2011	22,500	$ 2.90
December 2011	10,000	$ 1.94

The exercise price per share was the fair value of the underlying stock at the grant date. All options granted vest and become exercisable in four equal cumulative installments on each successive anniversary date of the grant and have a contractual term of ten years.

The Company computed the fair value of the options granted using the Black-Scholes option pricing model and the following assumptions:

	March 2010	August 2010	December 2010	February 2011	December 2011
Expected volatility	50.16%	50.16%	49.41%	49.41%	50.21%
Dividend yield	—	—	—	—	—
Risk-free interest rate	3.14%	2.00%	2.62%	2.84%	1.41%
Expected life (years)	6.25	6.25	6.25	6.25	6.25

The Company estimated the volatility of the underlying common stock at the date of grant based on the historical volatility of the Company's common stock as well as the historical volatility of comparable public companies. The risk-free interest rate for periods within the contractual life of the options is based on the U.S. Treasury yield curve in effect at the time of grant. Expected life was calculated using a simplified method as allowed by ASC 718, "Stock Compensation", due to lack of relevant historical data.

The following summarizes stock option transactions for the year ended December 31, 2011:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2010	1,520,713	$ 3.76	6.8	$ 312,460
Granted	32,500	$ 2.60		
Exercised	—	—		
Forfeited	34,496	$ 4.79		
Outstanding at December 31, 2011	1,518,717	$ 3.71	5.9	$ -
Exercisable at December 31, 2011	1,182,217	$ 4.01	5.3	$ -
Vested at December 31, 2011	1,182,217	$ 4.01	5.3	$ -
Unvested at December 31, 2011	336,500	$ 2.64	8.0	$ -

Intrinsic value is the amount by which the fair value of the underlying stock exceeds the exercise price of an option. If the fair value of the underlying stock is less than the exercise price of an option, there is no intrinsic value.

No options were exercised during 2011 or 2010.

The weighted average fair value of options granted during the years ended December 31, 2011 and 2010 was $1.04 and $1.27, respectively.

The total fair value of shares that vested during 2011 and 2010 was $276,000 and $488,000, respectively.

Stock-based compensation expense attributable to stock option awards was $268,000 and $386,000 for the years ended December 31, 2011 and 2010, respectively.

The remaining unrecognized compensation expense related to unvested awards at December 31, 2011 is $373,000 and the weighted-average period of time over which this expense will be recognized is 2.0 years.

The Company has not capitalized any stock-based compensation expense at December 31, 2011 or 2010. There have been no significant modifications to stock option awards during 2011 or 2010.

All unvested options at December 31, 2011 are expected to vest.

Restricted Stock Units

Restricted stock units outstanding as of December 31, 2011 were awarded to certain employees in 2010 and 2011. Restricted stock units were awarded by the board of directors of the Company, upon recommendation of the compensation committee of the board of directors of the Company, and are designated as performance awards subject to the terms and conditions of the 2006 Plan and the underlying award agreements. To support the Company's focus on creating long-term stockholder value, the awarded restricted stock units are subject to performance criteria based on earnings per share of the Company ("EPS") during the defined performance period. EPS will be determined by dividing the Company's consolidated net income or loss by the number of basic common shares of the Company outstanding during the defined performance years within the defined performance period. The calculation of the number of restricted stock units that will vest at the end of the defined performance period is based on an average of the EPS performance level achieved during each of the defined performance years. The number of restricted stock units earned during the defined performance period vary from 0% to 200% of the restricted stock units awarded based on EPS for each of the defined performance years in the defined performance year.

The performance period for restricted stock units granted in 2010 begins May 1, 2010 and ends December 31, 2012. EPS will be determined by dividing the Company's consolidated net income or loss by the number of basic common shares of the Company for the period May 1, 2010 through December 31, 2010 and each of the twelve-month periods beginning January 1 and ending December 31 for 2011 and 2012 (each, a performance year).

The performance period for restricted stock units granted in 2011 begins January 1, 2011 and ends December 31, 2013. EPS will be determined by dividing the Company's consolidated net income or loss by the number of basic common shares of the Company for each of the twelve-month periods beginning January 1 and ending December 31 for 2011, 2012 and 2013 (each, a performance year).

If, at the end of the defined performance period, at least threshold performance level has been achieved, the earned restricted stock units will vest and common stock of the Company will be issued. The number of shares of common stock of the Company awarded will be based on the fair market value of the Company's common stock on the date of grant ($2.36 for restricted stock units granted in 2010 and $2.19 for restricted stock units granted in 2011).

The following summarizes restricted stock unit transactions for the year ended December 31, 2011:

	Performance Units	Weighted Average Grant-Date Fair Value
Outstanding at December 31, 2010	127,119	$ 2.36
Granted	652,968	$ 2.19
Forfeited	226,802	$ 2.24
Earned & Converted	—	$ —
Outstanding at December 31, 2011	553,285(1)	$ 2.21

(1) Assuming maximum payout for remaining performance years.

The Company determines the fair value of restricted stock unit awards based on the closing trade price of the Company's common stock on the date of grant. Compensation expense is recognized using the straight-line method over the performance period. The amount of compensation expense recognized is based upon the estimated number of restricted stock units expected to be earned. The Company reassesses this estimate at each reporting period and adjusts the total amount of compensation expense to be recognized accordingly.

For restricted stock units granted in 2010, threshold performance for the period May 1, 2010 through December 31, 2010, and for the period January 1, 2011 through December 31, 2011, were not achieved and, based on assumptions as of December 31, 2011, the Company estimated that threshold performance would not be achieved for the remaining defined performance year and that none of the awarded restricted stock units would be earned and as a result no compensation expense has been recognized in 2011 or 2010.

As of December 31, 2011, the Company estimates that 228,311 of the restricted stock units granted in 2011 will be earned (total compensation expense of $500,000). The Company has recognized $167,000 of compensation expense in 2011 related to these restricted stock unit awards.

As of December 31, 2011, the maximum number of restricted stock units granted in 2010 and 2011 that might be earned is 63,559 and 489,726, respectively.

14. OTHER EMPLOYEE BENEFIT PLANS

The Company sponsors a 401(k) Retirement Plan (the "401(k) Plan"). All employees of Heeling Sports Limited who are 21 years of age or older are eligible to enroll in the 401(k) Plan. The Company expensed contributions of $58,000 and $48,000 during 2011 and 2010, respectively.

15. RELATED-PARTY TRANSACTIONS

One of the Company's patent attorneys is also a stockholder of the Company. The Company capitalized $32,000 and $120,000 of patent and trademark related costs in 2011 and 2010, respectively; and, expensed (general and administrative) $294,000 and $854,000 in 2011 and 2010, respectively, of fees and expenses paid to this attorney's law firm. Additionally, this patent attorney's law firm provides general corporate legal counsel to the Company. The Company expensed $59,000 and $114,000 for these services during 2011 and 2010, respectively. This expense is included in general and administrative expense. The Company owed $16,000 and $158,000 to this law firm as of December 31, 2011 and 2010, respectively.

Effective as of April 30, 2008, the Company's Senior Vice President resigned his position with the Company and entered into a Consulting Agreement with the Company. The Consulting Agreement terminated on June 30, 2010. Under the Consulting Agreement, the former Senior Vice President (the "Consultant") provided the Company (i) consulting services relating to mergers and acquisitions, (ii) support services in connection with the prosecution or defense of litigation, arbitration, business, or investigatory matter relating to the Company, and (iii) other services agreed upon by the parties. The primary compensation under the Consulting Agreement was (i) a fee for merger and acquisition services to be paid in 25 monthly installments of $10,780 per month beginning June 30, 2008, (ii) success

fees more fully described in the Consulting Agreement and equal to varying percentages of the total value of certain mergers or acquisitions originated by the Consultant, (iii) a fee of $125 per hour (up to a maximum of $1,000 per day) for litigation support services rendered, and (iv) a fee of $125 per hour (up to a maximum of $1,000 per day for actual time billed) for services rendered for matters other than merger and acquisition services or litigation support. The Company also reimbursed the Consultant for his expenses incurred in connection with the performance of his services under the Consulting Agreement. The Company's former Senior Vice President continues to remain as a member of the Company's Board of Directors. Options previously granted to the former Senior Vice President continued to vest in accordance with the Heelys, Inc. 2006 Stock Incentive Plan so long as he was a member of the Company's Board of Directors. As of June 30, 2010, all options had fully vested. The Company recognized $65,000 in expense related to the Consulting Agreement in 2010. These charges are included in general and administrative expense. As of December 31, 2011 and 2010, no payable existed related to the Consulting Agreement.

16. SEGMENT REPORTING

Operating results are assessed based on geographic areas to make decisions about necessary resources and in assessing performance. Consequently, based on the nature of the financial information that is received by the chief executive officer as chief operating decision maker, the Company has two reportable segments for financial reporting purposes. Each segment derives revenue primarily from the sale of HEELYS-wheeled footwear. Intercompany balances and transactions have been eliminated.

	Year Ended December 31, 2011 (In thousands)			
	Domestic	International	Unallocated	Consolidated
Net Sales	$ 11,903	$ 20,114	$ -	$ 32,017
Cost of Sales	7,199	11,498	-	18,697
Gross Profit	4,704	8,616	-	13,320
Selling, General and Administrative Expenses	8,394	10,106	986	19,486
Income (Loss) from Operations	(3,690)	(1,490)	(986)	(6,166)
Other (Income) Expense, net	(595)	31	(241)	(805)
Income (Loss) before Income Taxes	$ (3,095)	$ (1,521)	$ (745)	$ (5,361)
Inventory impairment (included in cost of sales)	$ 57	$ 1,189	$ -	$ 1,246
Depreciation and amortization (included in cost of sales)	$ 74	$ -	$ -	$ 74
Depreciation and amortization (included in SG&A)	$ 236	$ 449	$ -	$ 685

	Year Ended December 31, 2010 (In thousands)			
	Domestic	International	Unallocated	Consolidated
Net Sales	$ 8,641	$ 21,795	$ -	$ 30,436
Cost of Sales	6,033	11,750	-	17,783
Gross Profit	2,608	10,045	-	12,653
Selling, General and Administrative Expenses	8,646	7,868	883	17,397
Income (Loss) from Operations	(6,038)	2,177	(883)	(4,744)
Other (Income) Expense, net	(905)	165	(280)	(1,020)
Income (Loss) before Income Taxes	$ (5,133)	$ 2,012	$ (603)	$ (3,724)
Inventory impairment (included in cost of sales)	$ 352	$ -	$ -	$ 352
Depreciation and amortization (included in cost of sales)	$ 109	$ -	$ -	$ 109
Depreciation and amortization (included in SG&A)	$ 342	$ 319	$ -	$ 661

Other income attributed to domestic operations, includes interest income of $42,000 and $80,000 in 2011 and 2010, respectively, earned on cash (including cash equivalents) and investments, and other income of $553,000 in 2011 and $825,000 in 2010. Other income is primarily attributable to settlements of patent and trademark litigations. Litigation settlement payments related to intellectual property legal matters (whether received by the Company or paid by the Company) are reported as other income (expense) and attributed to either domestic or international operations as appropriate. Legal fees related to intellectual property matters and associated enforcement are included in general and administrative expense and are attributed to either domestic or international operations as appropriate.

Other income (expense), net, attributed to international operations, is primarily gains (losses) generated by transactions denominated in a currency different from the functional currency of the Company's Belgian and Japanese subsidiaries.

Although the Company's international operations benefit from centrally managed costs, such as compensation of the Company's executive officers, product development efforts and operating related insurance coverage, these costs have not been allocated to the international operations and are fully attributed to domestic operations.

Unallocated items, included in the tables above, include professional fees incurred at the consolidated level, including fees for tax, accounting and other consulting and professional services that are not directly attributable to operating either the domestic or international business, fees paid to members of the Company's board of directors, premiums for directors' and officers' insurance, other miscellaneous costs directly attributable to operating as a public company and interest income earned on monies and investments held at the Heelys, Inc. entity level.

	As of December 31, 2011			
	Domestic	International	Unallocated	Consolidated
	(in thousands)			
Total Assets	$ 22,402	$ 13,317	$ 43,094	$ 78,813
Property and Equipment, net	$ 451	$ 119	$ -	$ 570
Goodwill	$ -	$ 1,532	$ -	$ 1,532

	As of December 31, 2010			
	Domestic	International	Unallocated	Consolidated
	(in thousands)			
Total Assets	$ 28,535	$ 9,292	$ 43,987	$ 81,814
Property and Equipment, net	$ 692	$ 106	$ -	$ 798
Goodwill	$ -	$ 1,568	$ -	$ 1,568

Unallocated assets, included in the tables above, are primarily cash (including cash equivalents) and investments held at the Heelys, Inc. entity level.

The functional currency of the Company's Belgian subsidiary is the Euro and for the Japanese subsidiary the Japanese Yen. Because these functional currencies are different than the Company's reporting currency, which is the U.S. dollar, the assets of the Belgian and Japanese subsidiaries are translated at the rate of exchange as of the balance sheet date. The change in the U.S. dollar value of goodwill is solely the result of the impact of the fluctuation in the exchange rate.

Sales in the Company's Italian market accounted for 19.6% and 8.4% of consolidated net sales in 2011 and 2010, respectively. Sales in the Company's French market accounted for 17.0% and 21.4% of consolidated net sales in 2011 and 2010, respectively. Sales in the Company's German market accounted for 6.8% and 12.4% of consolidated net sales, respectively. Sales in the Company's Japan market accounted for 5.9% and 17.7% of consolidated net sales in 2011 and 2010, respectively. No other country, other than the United States, accounted for 10% or more of the Company's consolidated net sales in 2011 or 2010.

Customers of the Company consist of retail stores in the U.S. and certain European countries, and international wholesale distributors. The customers, individually or considered as a group under common ownership, which accounted for greater than 10% of net sales during the periods reflected were as follows:

	Year Ended December 31,	
	2011	2010
Oxylane Group	12%	12%
Privee AG Corporation	-	18%

Oxylane Group is a French sporting goods retailer operating under the name Decathlon. Privee AG Corporation ("Privee AG") was the Company's independent distributor in Japan.

On November 25, 2010, the Company notified Privee AG that it would not be renewing its distributor agreement with Privee AG. On February 28, 2011, the Company's distributor agreement with Privee AG terminated. In February 2011, the Company formed Heeling Sports Japan K.K., a Japanese corporation and indirect wholly-owned subsidiary, to manage its operations in Japan and to take over distribution in that country effective March 1, 2011.

17. SUBSEQUENT EVENTS

As part of an initiative to improve efficiency and reduce costs, the Company began taking steps in the first quarter of 2012 to close its office in Brussels, Belgium and transition the business operations conducted through that office to its French and German offices. As part of this initiative, the Company expects to reduce its workforce in Belgium. These workforce reductions will primarily come from the elimination of certain finance, supply chain and customer service functions. The work performed by these persons mostly will be absorbed by the French, German and U.S. office employees. The Company anticipates hiring limited personnel to assist with accounting and logistical support in those offices. Financial management and reporting for the Company's Belgian subsidiary will be transitioned to its headquarters in the United States. The actions taken thus far to implement this initiative are expected to be substantially completed by June 30, 2012, with the total cumulative pre-tax costs estimated to be $0.9 million to $1.3 million. The Com10.8(p)-(m)9.10.02 (nt and6(managem)-3.50)-5.1((.

Exhibit 21.1

List of Subsidiaries of the Registrant

Name of Subsidiary	Jurisdiction of Organization
Heeling Management Corp.	Texas
Heeling Holding Corporation	Nevada
Heeling Sports Limited	Texas
Heeling Sports EMEA, SPRL	Belgium
Heeling Sports Japan K.K.	Japan

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have issued our report dated March 21, 2012, with respect to the consolidated financial statements included in the Annual Report of Heelys, Inc. on Form 10-K for the year ended December 31, 2011. We hereby consent to the incorporation by reference of said report in the Registration Statements of Heelys, Inc. on Forms S-8 (File No. 333-139476, effective December 19, 2006, and File No. 333-152929, effective August 11, 2008, and File No. 333-167042, effective May 24, 2010).

/s/ Grant Thornton LLP

Dallas, Texas
March 21, 2012

EXHIBIT 31.1

CERTIFICATION

I, Thomas C. Hansen, certify that:

1. I have reviewed this annual report on Form 10-K of Heelys, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) 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 21, 2012

By: /s/ THOMAS C. HANSEN
Thomas C. Hansen
Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Craig D. Storey, certify that:

1. I have reviewed this annual report on Form 10-K of Heelys, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) 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

(d) 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 21, 2012

By: /s/ CRAIG D. STOREY
Craig D. Storey
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION 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 Heelys, Inc. (the "Company") for the period ending December 31, 2011, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Thomas C. Hansen, Chief Executive Officer of the Company, and Craig D. Storey, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to our knowledge, that:

(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.

Date: March 21, 2012

By: /s/ THOMAS C. HANSEN
Thomas C. Hansen
Chief Executive Officer

By: /s/ CRAIG D. STOREY
Craig D. Storey
Chief Financial Officer

The foregoing certification is being furnished to the Securities and Exchange Commission as an Exhibit to the Report.