BIG LOTS INC
Form 10-Q
September 10, 2013
Table of Contents

## UNITED STATES <br> SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended August 3, 2013
or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from $\qquad$ to $\qquad$
Commission File Number 1-8897
BIG LOTS, INC.
(Exact name of registrant as specified in its charter)

Ohio
(State or other jurisdiction of incorporation or organization)

300 Phillipi Road, P.O. Box 28512, Columbus, Ohio
(Address of principal executive offices)
(614) 278-6800
(Registrant's telephone number, including area code)

06-1119097
(I.R.S. Employer Identification No.)

43228-5311
(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

## Yesp Noo

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).

Yesp Noo
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 p Accelerated filer o Non-accelerated filer o Smaller reporting company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o Nop
The number of the registrant's common shares, $\$ 0.01$ par value, outstanding as of September 6, 2013, was 58,288,947.

## Table of Contents

BIG LOTS, INC.
FORM 10-Q
FOR THE FISCAL QUARTER ENDED AUGUST 3, 2013

## TABLE OF CONTENTS

Part I. Financial Information ..... $\underline{2}$
Item 1. Financial Statements ..... 2
a) 2013 (Unaudited) and July 28, 2012 (Unaudited)
b) Consolidated Statements of Comprehensive Income for the Thirteen and Twenty-Six Weeks Ended August 3, 2013 (Unaudited) and July 28, 2012 (Unaudited) ..... 3
c) Consolidated Balance Sheets at August 3. 2013 (Unaudited) and February 2, 2013 ..... 4
d) Consolidated Statements of Shareholders' Equity for the Twenty-Six Weeks Ended August 3, 2013 (Unaudited) and July 28, 2012 (Unaudited) ..... 5
e) Consolidated Statements of Cash Flows for the Twenty-Six Weeks Ended August 3, 2013 (Unaudited) and July 28, 2012 (Unaudited) ..... 6
e) Notes to Consolidated Financial Statements (Unaudited) ..... 7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ..... 19
Item 3. Quantitative and Qualitative Disclosures About Market Risk ..... $\underline{28}$
Item 4. Controls and Procedures ..... $\underline{28}$
Part II. Other Information ..... $\underline{29}$
Item 1. Legal Proceedings ..... $\underline{29}$
Item 1A. Risk Factors ..... $\underline{29}$
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds ..... $\underline{29}$
Item 3. Defaults Upon Senior Securities ..... $\underline{29}$
Item 4. Mine Safety Disclosures ..... 30
Item 5. Other Information ..... 30
Item 6. Exhibits ..... 30
Signature ..... 301

## Table of Contents

Part I. Financial Information

Item 1. Financial Statements
BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations (Unaudited)
(In thousands, except per share amounts)


The accompanying notes are an integral part of these consolidated financial statements.

## Table of Contents

BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income (Unaudited) (In thousands)

|  | Thirteen Weeks Ended |  |  | Twenty-Six Weeks Ended |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | August 3, 2013 | July 28, 2012 |  | August 3, 2013 | July 28, 2012 |
| Net income | \$18,126 | \$22,075 |  | \$50,459 | \$62,821 |
| Other comprehensive income (loss): |  |  |  |  |  |
| Foreign currency translation | (1,390 | ) (914 | ) | (1,965 | ) (255 |
| Amortization of pension, net of tax benefit of $\$(170), \$(192), \$(336)$, and \$(457), respectively | 248 | 293 |  | 499 | 705 |
| Valuation adjustment of pension, net of tax benefit of $\$ 0, \$(102), \$ 0$, and \$(102), respectively | - | 156 |  | - | 156 |
| Total other comprehensive income (loss) | (1,142 | ) (465 | ) | (1,466 | ) 606 |
| Comprehensive income | \$16,984 | \$21,610 |  | \$48,993 | \$63,427 |

The accompanying notes are an integral part of these consolidated financial statements.

## Table of Contents

BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except par value)
(Unaudited)
August 3, 2013 February 2, 2013

## ASSETS

Current assets:
Cash and cash equivalents $\quad \$ 63,810 \quad \$ 60,581$
Inventories
Deferred income taxes
Other current assets
Total current assets
Property and equipment - net
Deferred income taxes
Goodwill
Other assets
Total assets

## LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:
Accounts payable
Property, payroll, and other taxes
Accrued operating expenses
Insurance reserves
KB bankruptcy lease obligation
Accrued salaries and wages
Income taxes payable
Total current liabilities
Long-term obligations
Deferred income taxes
Deferred rent
Insurance reserves
Unrecognized tax benefits
Other liabilities
\$427,243 \$393,652

Shareholders' equity:
Preferred shares - authorized 2,000 shares; \$0.01 par value; none issued
Common shares - authorized 298,000 shares; \$0.01 par value; issued 117,495
shares; outstanding 57,429 shares and 57,269 shares, respectively
Treasury shares - 60,066 shares and 60,226 shares, respectively, at cost
Additional paid-in capital
Retained earnings
Accumulated other comprehensive loss
Total shareholders' equity
Total liabilities and shareholders' equity
The accompanying notes are an integral part of these consolidated financial statements.

## Table of Contents

BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity (Unaudited) (In thousands)

| Common | Treasury | Additional | Accumulated <br> Paid-In |
| :--- | :--- | :--- | :--- |
| Retained |  |  |  | Other | Earnings |
| :--- | ComprehensiveTotal


| $\begin{aligned} & \text { Balance - January } 28 \text {, } \\ & 2012 \end{aligned}$ | 63,609 | \$1,175 | 53,886 | \$(1,423,524 | )\$542,160 | \$1,718,941 | \$(15,519 | ) \$823,233 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Comprehensive income | - | - | - | - | - | 62,821 | 606 | 63,427 |
| Purchases of common shares | (6,603) | )- | 6,603 | (252,759 | )- | - | - | (252,759 |
| Exercise of stock options | 1,389 | - | (1,389 | ) 36,783 | (3,785 | )- | - | 32,998 |
| Restricted shares vested | 478 | - | (478 | ) 12,650 | (12,650 | )- | - | - |
| Tax benefit from share-based awards | - | - | - | - | 8,071 | - | - | 8,071 |
| Share activity related to deferred compensation plan | 8 | - | (8 | ) 37 | 317 | - | - | 354 |
| Share-based employee compensation expense | - | - | - | - | 14,684 | - | - | 14,684 |
| Balance - July 28, 2012 | 58,881 | 1,175 | 58,614 | (1,626,813 | ) 548,797 | 1,781,762 | (14,913 | ) 690,008 |
| Comprehensive income | - | - | - | - | - | 114,300 | 1,583 | 115,883 |
| Purchases of common shares | (1,629) | )- | 1,629 | (51,279 | )- | - | - | (51,279 |
| Exercise of stock options | 17 | - | (17 | )483 | (193 | )- | - | 290 |
| Restricted shares vested | - | - | - | (1 | )1 | - | - | - |
| Tax benefit from share-based awards | - | - | - | - | 46 | - | - | 46 |
| Share activity related to deferred compensation plan | - | - | - | - | (1 | )- | - | (1 |
| Share-based employee compensation expense | - | - | - | - | 3,195 | - | - | 3,195 |
| $\begin{aligned} & \text { Balance - February 2, } \\ & 2013 \end{aligned}$ | 57,269 | 1,175 | 60,226 | (1,677,610 | ) 551,845 | 1,896,062 | (13,330 | ) 758,142 |
| Comprehensive income | - | - | - | - | - | 50,459 | (1,466 | ) 48,993 |
| Purchases of common shares | (6 | )- | 6 | (214 | )- | - | - | (214 |
| Exercise of stock options | 126 | - | (126 | ) 3,505 | (884 | )- | - | 2,621 |
| Restricted shares vested | 40 | - | (40 | ) 1,109 | (1,109 | )- | - | - |
| Tax benefit from share-based awards | - | - | - | - | 280 | - | - | 280 |
| Share activity related to deferred compensation plan | - | - | - | - | - | - | - | - |
| Share-based employee compensation expense | - | - | - | - | 7,798 | - | - | 7,798 |

The accompanying notes are an integral part of these consolidated financial statements.
5

## Table of Contents

BIG LOTS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

Operating activities:
Net income
Twenty-Six Weeks Ended
August 3, 2013 July 28, 2012

Adjustments to reconcile net income to net cash provided by operating activities:
Depreciation and amortization expense
$\$ 50,459 \quad \$ 62,821$

Deferred income taxes
49,485 46,754
Gain on disposition of equipment
Non-cash share-based compensation expense
Excess tax benefit from share-based awards
(15,339 ) (351
)(351 )

Pension expense, net of contributions
(119) (196

14,684
) (8,078 )
Change in assets and liabilities, excluding effects of acquisition and foreign currency adjustments:

| Inventories | 2,939 | $(55,916$ |
| :--- | :--- | :--- |
| Accounts payable | 33,962 | 59,455 |
| Current income taxes | $(66,823$ | $)(45,185$ |
| Other current assets | $(8,090$ | $)(5,902$ |
| Other current liabilities | 14,420 | 9,050 |
| Other assets | $(840$ | $)(2,437$ |
| Other liabilities | 12,957 | 12,463 |
| Net cash provided by operating activities | 82,018 | 88,749 |
| Investing activities: |  |  |
| Capital expenditures | $(51,690$ | $)(60,721$ |
| Cash proceeds from sale of property and equipment | 1,602 | 461 |
| Other | $(13$ | $)(13$ |
| Net cash used in investing activities | $(50,101$ | $)(60,273$ |
| Financing activities: | $(29,500$ | $) 176,900$ |
| Net (repayments of) proceeds from borrowings under bank credit facility | $(590$ | $)(766$ |
| Payment of capital lease obligations | 2,621 | 32,998 |
| Proceeds from the exercise of stock options | 280 | 8,078 |
| Excess tax benefit from share-based awards | $(959$ | $)$ |
| Deferred bank credit facility fees paid | $(214$ | $)(252,759$ |
| Payment for treasury shares acquired | - | 354 |
| Other | $(28,362$ | $)(35,195$ |
| Net cash used in financing activities | $(326$ | $)(149$ |
| Impact of foreign currency on cash | 3,229 | $(6,868$ |
| Increase (decrease) in cash and cash equivalents |  |  |
| Cash and cash equivalents: | 60,581 | 68,547 |
| Beginning of period | $\$ 63,810$ | $\$ 61,679$ |

The accompanying notes are an integral part of these consolidated financial statements.

## Table of Contents

BIG LOTS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

## NOTE 1 - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

All references in this report to "we," "us," or "our" are to Big Lots, Inc. and its subsidiaries. We are North America's largest broadline closeout retailer. At August 3, 2013, we operated 1,593 stores in two countries: the United States of America ("U.S.") and Canada. We make available, free of charge, through the "Investor Relations" section of our website (www.biglots.com) under the "SEC Filings" caption, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), as soon as reasonably practicable after we file such material with, or furnish it to, the Securities and Exchange Commission ("SEC"). The contents of our websites are not part of this report.

The accompanying consolidated financial statements and these notes have been prepared in accordance with the rules and regulations of the SEC for interim financial information. The consolidated financial statements reflect all normal recurring adjustments which management believes are necessary to present fairly our financial condition, results of operations, and cash flows for all periods presented. These consolidated financial statements, however, do not include all information necessary for a complete presentation of financial condition, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America ("GAAP"). Interim results may not necessarily be indicative of results that may be expected for, or actually result during, any other interim period or for the year as a whole. We have historically experienced, and expect to continue to experience, seasonal fluctuations, with a larger percentage of our net sales and operating profit realized in our fourth fiscal quarter. The accompanying consolidated financial statements and these notes should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended February 2, 2013 ("2012 Form 10-K").

## Fiscal Periods

Our fiscal year ends on the Saturday nearest to January 31, which results in fiscal years consisting of 52 or 53 weeks. Unless otherwise stated, references to years in this report relate to fiscal years rather than calendar years. Fiscal year 2013 ("2013") is comprised of the 52 weeks that began on February 3, 2013 and will end on February 1, 2014. Fiscal year 2012 ("2012") was comprised of the 53 weeks that began on January 29, 2012 and ended on February 2, 2013. The fiscal quarters ended August 3, 2013 ("second quarter of 2013") and July 28, 2012 ("second quarter of 2012") were both comprised of 13 weeks. The year-to-date periods ended August 3, 2013 ("year-to-date 2013") and July 28, 2012 ("year-to-date 2012") were both comprised of 26 weeks.

Merchandise Inventories
We assign cost to merchandise inventories using the average cost retail inventory method. Under our previous inventory management system which was used through the end of 2011, we calculated average cost at the department level which constituted approximately 50 inventory cost pools. On January 29, 2012, the first day of 2012, we completed the implementation of new inventory management systems, which has allowed us to more precisely determine our inventory cost under the retail method. Since the beginning of 2012, we have calculated average cost at the class level which constitutes approximately 350 inventory cost pools.

As the impact of the accounting change on inventory for the first quarter of 2012 was immaterial, we recognized the cumulative effect of the change in accounting principle as a current year expense by recording a reduction in inventory and a corresponding increase to cost of sales of approximately $\$ 5.6$ million in the first quarter of 2012. This non-cash charge reduced the year-to-date 2012 income from continuing operations and net income by approximately $\$ 3.4$ million and reduced the year-to-date 2012 basic and diluted earnings per share from continuing operations by $\$ 0.05$.

Selling and Administrative Expenses
Selling and administrative expenses include store expenses (such as payroll and occupancy costs) and costs related to warehousing, distribution, outbound transportation to our stores, advertising, purchasing, insurance, non-income taxes, and overhead. Our selling and administrative expense rates may not be comparable to those of other retailers that include distribution and outbound transportation costs in cost of sales. Distribution and outbound transportation costs included in selling and administrative expenses were $\$ 39.9$ million and $\$ 39.6$ million for the second quarter of 2013 and the second quarter of 2012 , respectively, and $\$ 82.3$ million and $\$ 81.3$ million for the year-to-date 2013 and the year-to-date 2012, respectively.

7

## Table of Contents

Advertising Expense
Advertising costs, which are expensed as incurred, consist primarily of television and print advertising, internet marketing and advertising, and in-store presentations. Advertising expenses are included in selling and administrative expenses. Advertising expenses were $\$ 19.7$ million and $\$ 21.7$ million for the second quarter of 2013 and the second quarter of 2012, respectively, and $\$ 43.3$ million and $\$ 46.1$ million for the year-to-date 2013 and the year-to-date 2012, respectively.

## Foreign Currency Translation

The functional currency of our international subsidiary is the local currency of the country in which the subsidiary is located. We have one foreign subsidiary domiciled and operating in Canada. Foreign currency denominated assets and liabilities are translated into U.S. Dollars using the exchange rate in effect at the consolidated balance sheet date. Results of operations and cash flows are translated using the average exchange rates throughout the period. The effect of exchange rate fluctuations on translation of assets and liabilities is included as a component of shareholders' equity in accumulated other comprehensive income (loss). Gains and losses from foreign currency transactions, which are included in other income (expense), were a loss of $\$ 0.1$ million and immaterial for the second quarter of 2013 and the second quarter of 2012, respectively, and a loss of $\$ 0.3$ million and immaterial for the year-to-date 2013 and the year-to-date 2012, respectively.

## Supplemental Cash Flow Disclosures

The following table provides supplemental cash flow information for the year-to-date 2013 and 2012: Twenty-Six Weeks Ended
(In thousands)
Supplemental disclosure of cash flow information:
Cash paid for interest, including capital leases
Cash paid for income taxes, excluding impact of refunds
Non-cash activity:
Assets acquired under capital leases

| August 3, 2013 | July 28, 2012 |
| :--- | :--- |
| $\$ 1,127$ | $\$ 571$ |
| $\$ 119,707$ | $\$ 90,379$ |
| $\$-$ | $\$ 392$ |
| $\$ 11,850$ | $\$ 14,209$ |

During the year-to-date 2013 and the year-to-date 2012, our gross proceeds from borrowings under the bank credit facility (as described in note 2) were $\$ 596.7$ million and $\$ 523.8$ million, respectively, and our gross repayments of borrowings under the bank credit facility were $\$ 626.2$ million and $\$ 346.9$ million, respectively.

## Reclassifications

In the fourth quarter of 2012, we realigned select merchandise categories in our U.S. segment to be consistent with the realignment of our merchandising team and changes to our management reporting. Prior to the fourth quarter of 2012, we reported sales of our toys, books and sporting goods departments in the Play n' Wear category. We moved the toys, books and sporting goods departments out of the Play n' Wear category and repositioned them in the Hardlines \& Other category. We also moved the results of certain large closeout deals that are typically acquired through our alternate product sourcing operations out of the Hardlines \& Other category and repositioned them in the Play n' Wear category. We subsequently renamed our Hardlines \& Other category to Hardlines and Toys and renamed our Play n' Wear category to Electronics \& Other. Our Consumables category was also separated into a Food category and a Consumables category. The Consumables category now contains our health and beauty care, housekeeping supplies, household chemicals, paper products, pet, and home organization departments, while the Food category contains our various food and beverage departments. Fiscal 2012 sales results have been reclassified to reflect this realignment.

## Recent Accounting Pronouncements

There are currently no new accounting pronouncements with a future effective date that are of significance, or potential significance, to us.

Edgar Filing: BIG LOTS INC - Form 10-Q

## Table of Contents

## NOTE 2 - BANK CREDIT FACILITY

On July 22, 2011, we entered into a $\$ 700$ million five-year unsecured credit facility and, on May 30, 2013, we entered into an amendment of the credit facility that extended its expiration from July 22, 2016 to May 30, 2018 ("2011 Credit Agreement"). In connection with our entry into the 2011 Credit Agreement, we paid bank fees and other expenses in the aggregate amount of $\$ 3.0$ million, which are being amortized over the term of the agreement. In connection with the amendment of the 2011 Credit Agreement, we paid additional bank fees and other expenses in the aggregate amount of $\$ 1.0$ million, which are being amortized over the term of the amended agreement.

Borrowings under the 2011 Credit Agreement are available for general corporate purposes and working capital. The 2011 Credit Agreement includes a $\$ 10$ million Canadian swing loan sublimit, a $\$ 30$ million U.S. swing loan sublimit, a $\$ 150$ million letter of credit sublimit and a $\$ 200$ million Canadian revolving credit loan subfacility. The interest rates, pricing and fees under the 2011 Credit Agreement fluctuate based on our debt rating. The 2011 Credit Agreement allows us to select our interest rate for each borrowing from multiple interest rate options. The interest rate options are generally derived from the prime rate, LIBOR or CDOR. We may prepay revolving loans made under the 2011 Credit Agreement. The 2011 Credit Agreement contains financial and other covenants, including, but not limited to, limitations on indebtedness, liens and investments, as well as the maintenance of two financial ratios - a leverage ratio and a fixed charge coverage ratio. A violation of any of the covenants could result in a default under the 2011 Credit Agreement that would permit the lenders to restrict our ability to further access the 2011 Credit Agreement for loans and letters of credit and require the immediate repayment of any outstanding loans under the 2011 Credit Agreement. At August 3, 2013, we had $\$ 141.7$ million borrowings outstanding under the 2011 Credit Agreement and $\$ 19.7$ million was committed to outstanding letters of credit, leaving $\$ 538.6$ million available under the 2011 Credit Agreement.

## NOTE 3 - FAIR VALUE MEASUREMENTS

In connection with our nonqualified deferred compensation plan, we had mutual fund investments of $\$ 22.8$ million and $\$ 20.7$ million at August 3, 2013 and February 2, 2013, respectively, which were recorded in other assets. These investments were classified as trading securities and were recorded at their fair value. The fair values of mutual fund investments were Level 1 valuations under the fair value hierarchy because each fund's quoted market value per share was available in an active market.

The fair values of our long-term obligations are estimated based on the quoted market prices for the same or similar issues and the current interest rates offered for similar instruments. These fair value measurements are classified as Level 2 within the fair value hierarchy. Given the variable rate features and relatively short maturity of the instruments underlying our long-term obligations, the carrying value of these instruments approximates the fair value.

The carrying value of accounts receivable, accounts payable, and accrued expenses approximates fair value because of the relatively short maturity of these items.

## NOTE 4 - SHAREHOLDERS' EQUITY

## Earnings per Share

There were no adjustments required to be made to the weighted-average common shares outstanding for purposes of computing basic and diluted earnings per share and there were no securities outstanding at August 3, 2013 or July 28, 2012, which were excluded from the computation of earnings per share other than antidilutive stock options and restricted stock awards. For the second quarter of 2013 and the second quarter of 2012, 3.0 million and 2.0 million, respectively, of the stock options outstanding were antidilutive and excluded from the computation of diluted earnings per share. For the year-to-date 2013 and the year-to-date 2012, 2.8 million and 1.8 million, respectively, of the stock

## Edgar Filing: BIG LOTS INC - Form 10-Q

options outstanding were antidilutive and excluded from the computation of diluted earnings per share. Antidilutive stock options generally consist of outstanding stock options where the exercise price per share is greater than the weighted-average market price per share for our common shares for each period. Antidilutive stock options and restricted stock awards are excluded from the calculation because they decrease the number of diluted shares outstanding under the treasury stock method. For each of the second quarter of 2013, the second quarter of 2012, the year-to-date 2013 and the year-to-date 2012, the restricted stock awards that were antidilutive were immaterial.

## Table of Contents

## NOTE 5 - SHARE-BASED PLANS

We have issued nonqualified stock options, restricted stock awards and performance share units under our shareholder-approved equity compensation plans. Our restricted stock awards, as described below and in note 7 to the consolidated financial statements in our 2012 Form 10-K, are expensed and reported as nonvested shares. Our performance share units, as described below, are also expensed and reported as nonvested shares. We recognized share-based compensation expense of $\$ 3.2$ million and $\$ 6.6$ million in the second quarter of 2013 and the second quarter of 2012, respectively, and $\$ 7.8$ million and $\$ 14.7$ million for the year-to-date 2013 and the year-to-date 2012, respectively.

The weighted-average fair value of stock options granted and assumptions used in the model to estimate the fair value of stock options granted during each of the respective periods were as follows:

|  | Second Quarter |  | Year-to-Date |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
|  | 2013 | 2012 | 2013 |  | 2012 |  |
|  | $\$ 11.87$ | $\$ 13.48$ |  | $\$ 12.10$ | $\$ 14.23$ |  |
| Weighted-average fair value of stock options granted | 0.7 | $\% 0.5$ | $\%$ | 0.7 | $\% 0.6$ | $\%$ |
| Risk-free interest rate | 4.2 | 4.2 |  | 4.2 | 4.2 |  |
| Expected life (years) | 41.1 | $\% 43.4$ | $\%$ | 42.3 | $\% 41.0$ | $\%$ |
| Expected volatility | 3.0 | $\% 3.0$ | $\%$ | 3.0 | $\% 3.0$ | $\%$ |
| Expected annual forfeiture rate |  |  |  |  |  |  |

The following table summarizes stock option activity for the year-to-date 2013:

|  |  | Weighted <br> Average <br> Number of | Weighted <br> Average <br> Remaining <br> Options | Aggregate <br> Price Per <br> Intrinsic |
| :--- | :--- | :--- | :--- | :--- |
| Contractual |  |  |  |  |
| Value (000's) |  |  |  |  |

The stock options granted in the year-to-date 2013 vest in equal amounts on the first four anniversaries of the grant date and have a contractual term of seven years. The number of stock options expected to vest was based on our annual forfeiture rate assumption.

## Table of Contents

The following table summarizes the nonvested stock award activity other than stock options for the year-to-date 2013:

| Number of | Weighted <br> Average <br> Grant-Date |
| :--- | :--- |
| Shares | Fair Value Per |
|  | Share |
| 13783,609 | $\$ 42.25$ |
| 339,500 | 35.54 |
| - | - |
| $(248,300$ | $) 43.75$ |
| 874,809 | $\$ 39.22$ |
| 110,251 | 35.09 |
| $(39,784$ | 35.70 |
| $(138,300$ | $) 40.28$ |
| 806,976 | $\$ 38.64$ |

The nonvested restricted stock awards granted to employees in the year-to-date 2013 vest if certain financial performance objectives are achieved. If we meet a threshold financial performance objective and the grantee remains employed by us, the restricted stock will vest on the opening of our first trading window five years after the grant date of the award. If we meet a higher financial performance objective and the grantee remains employed by us, the restricted stock will vest on the first trading day after we file our Annual Report on Form 10-K with the SEC for the fiscal year in which the higher objective is met. On the grant date, we estimated a three-year period for vesting of the nonvested restricted stock awards granted in 2013 based on the projected achievement of the higher financial performance objective.

In the second quarter of 2013, 20,784 common shares underlying the restricted stock awards granted in 2012 to the non-employee members of our Board of Directors vested on the trading day immediately preceding our 2013 Annual Meeting of Shareholders. These awards were part of the annual compensation granted in 2012 to the non-employee members of the Board of Directors. Additionally, in the second quarter of 2013, each non-employee elected to our Board of Directors at our 2013 Annual Meeting of Shareholders received an annual restricted stock award having a grant date fair value of approximately $\$ 100,000$. The 2013 restricted stock awards will vest on the earlier of (1) the trading day immediately preceding our 2014 Annual Meeting of Shareholders, or (2) the non-employee director's death or disability. However, the restricted stock award will not vest if the non-employee director ceases to serve on our Board of Directors before either vesting event occurs.

In the second quarter of 2013, in connection with his appointment as CEO and President, Mr. David J. Campisi was awarded 37,800 performance share units, which vest based on the achievement of share price performance goals. The performance share units have a contractual term of seven years. If the performance goals applicable to the performance share units are not achieved prior to expiration, the awards will be forfeited.

The following activity occurred under our share-based plans during the respective periods shown:

|  | Second Quarter |  | Year-to-Date |  |
| :--- | :--- | :--- | :--- | :--- |
| (In thousands) | 2013 | 2012 | 2013 | 2012 |
| Total intrinsic value of stock options exercised | $\$ 749$ | $\$ 953$ | $\$ 1,789$ | $\$ 29,075$ |
| Total fair value of restricted stock vested | 1,434 | 804 | 1,434 | 21,907 |

The total unearned compensation cost related to all share-based awards outstanding at August 3, 2013 was approximately $\$ 43.3$ million. This compensation cost is expected to be recognized through July 2017 based on existing vesting terms with the weighted-average remaining expense recognition period being approximately 2.1 years

Edgar Filing: BIG LOTS INC - Form 10-Q
from August 3, 2013.

11

## Table of Contents

## NOTE 6 - EMPLOYEE BENEFIT PLANS

We maintain a qualified defined benefit pension plan and a nonqualified supplemental defined benefit pension plan covering certain employees whose hire date occurred before April 1, 1994.

The weighted-average assumptions used to determine net periodic pension cost for our plans were as follows:

|  | 2013 | 2012 | $\%$ |
| :--- | :--- | :--- | :--- |
| Discount rate | 4.6 | $\% 5.0$ | $\%$ |
| Rate of increase in compensation levels | 3.5 | $\% 3.5$ | $\%$ |
| Expected long-term rate of return | 5.1 | $\% 5.5$ | $\%$ |

The components of combined net periodic pension cost were as follows:

|  | Second Quarter |  | Year-to-Date |  |
| :--- | :--- | :--- | :--- | :--- |
| (In thousands) | 2013 | 2012 | 2013 | 2012 |
| Service cost - benefits earned in the period | $\$ 521$ | $\$ 458$ | $\$ 1,043$ | $\$ 1,085$ |
| Interest cost on projected benefit obligation | 760 | 806 |  | 1,520 |
| Expected investment return on plan assets | $(724$ | $)(773$ | $)$ | $(1,447$ |
| Amortization of actuarial loss | 423 | 489 | 846 | 1,646 |
| Amortization of prior service cost | $(8$ | $)(8$ | $)$ | $(17$ |
| Amortization of transition obligation | 3 | 4 | 6 | $(172$ |
| Settlement loss | - | 258 | - | 7 |
| Net periodic pension cost | $\$ 975$ | $\$ 1,234$ | $\$ 1,951$ | $\$ 2,606$ |

We currently expect no required contributions to the qualified defined benefit pension plan during 2013. We will contribute to the nonqualified supplemental defined benefit pension plan as benefits are paid to plan participants, if any, because the nonqualified plan is not a funded plan.

## NOTE 7 - INCOME TAXES

Based on an evaluation of currently available information, we have fully reduced the amount of net deferred income tax assets (including a net operating loss carryforward) of our Canadian segment, as well as the deferred tax benefit of the loss generated by our Canadian segment since the acquisition, by a valuation allowance.

We have estimated the reasonably possible expected net change in unrecognized tax benefits through August 2, 2014, based on (1) expected cash and noncash settlements or payments of uncertain tax positions, and (2) lapses of the applicable statutes of limitations for unrecognized tax benefits. The estimated net decrease in unrecognized tax benefits for the next 12 months is approximately $\$ 4.0$ million. Actual results may differ materially from this estimate.

# Edgar Filing: BIG LOTS INC - Form 10-Q 

## Table of Contents

## NOTE 8 - CONTINGENCIES

In 1998, an action was filed against us in the District Court, 224th Judicial District, in Bexar County, Texas ("State Court") by a plaintiff claiming she was injured when she fell in one of our stores ("Rivera matter"). The Rivera matter was removed to the U.S. District Court for the Western District of Texas ("Federal Court") and the claim was fully litigated. Ultimately, the Federal Court granted summary judgment in our favor in January 2000. The plaintiff re-filed the same complaint in April 2000 in the State Court and then obtained a default judgment against us on June 20, 2000 in the amount of approximately $\$ 1.5$ million plus post-judgment interest. No effort was made to collect on this judgment by the plaintiff until February 2009, when we were served with a writ of execution of judgment. We filed a petition for a bill of review with the State Court. Since that time, the Federal Court issued an order reflecting that its January 2000 order was a summary judgment with prejudice in our favor. Notwithstanding the Federal Court's order, the State Court rendered a summary judgment decision in the plaintiff's favor. We appealed the State Court's decision and separately asked the Federal Court to issue an injunction against the State Court's proceedings. On March 25, 2010, the Federal Court denied our motion for an injunction and denied the plaintiff's motion to reconsider the Federal Court's order confirming that it granted summary judgment with prejudice. On April 6, 2010, the plaintiff appealed the Federal Court's ruling to the U.S. Court of Appeals for the Fifth Circuit. On June 22, 2010, the Texas Court of Appeals heard oral arguments in our appeal of the State Court's decision. On November 3, 2010, the Texas Court of Appeals affirmed the State Court ruling. On December 17, 2010, we filed a petition for review with the Supreme Court of Texas. On July 15, 2011, the U.S. Court of Appeals for the Fifth Circuit affirmed the Federal Court's decision to dismiss the Rivera matter with prejudice in our favor. On July 26, 2011, the plaintiff filed a petition with the U.S. Court of Appeals for the Fifth Circuit seeking a rehearing, which petition was denied on August 17, 2011. On August 17, 2011, the plaintiff filed a brief on the merits of the Rivera matter with the Supreme Court of Texas. The Supreme Court of Texas granted our petition for review. In September 2012, the Supreme Court of Texas held that the default judgment was not void due to defects in service, but that there is evidence of extrinsic fraud and remanded the case to the State Court for a trial on the fraud issue. The State Court held a trial in April 2013, and the jury held against us thus enforcing the initial State Court judgment in favor of the plaintiff. As a result, we accrued a pretax charge of $\$ 5.1$ million in the first quarter of 2013 to reflect the amount of the initial State Court judgment of approximately $\$ 1.5$ million plus post-judgment interest from the June 2000 judgment through the end of the first quarter of 2013. On June 7, 2013, we filed with the State Court a motion for judgment notwithstanding the verdict and a motion for a new trial. The parties settled this matter for $\$ 4.4$ million in July 2013. As a result, an adjustment was made to the accrual for this matter that benefitted the second quarter of 2013 by $\$ 0.7$ million.
On May 21, May 22 and July 2, 2012, three shareholder derivative lawsuits were filed in the U.S. District Court for the Southern District of Ohio against us and certain of our current and former outside directors and executive officers (Jeffrey Berger, David Kollat, Brenda Lauderback, Philip Mallott, Russell Solt, Dennis Tishkoff, Robert Claxton, Joe Cooper, Steven Fishman, Charles Haubiel, Timothy Johnson, John Martin, Norman Rankin, Paul Schroeder, Robert Segal and Steven Smart). The lawsuits were consolidated, and, on August 13, 2012, plaintiffs filed a consolidated complaint, which generally alleges that the individual defendants traded in our common shares based on material, nonpublic information concerning our guidance for fiscal 2012 and the first quarter of fiscal 2012 and the director defendants failed to suspend our share repurchase program during such trading activity. The consolidated complaint asserts claims under Ohio law for breach of fiduciary duty, unjust enrichment, misappropriation of trade secrets and corporate waste and seeks declaratory relief and disgorgement to us of proceeds from any wrongful sales of our common shares, plus attorneys' fees and expenses. The defendants have filed a motion to dismiss the consolidated complaint, and that motion is fully briefed and awaiting a decision.

On July 9, 2012, a putative securities class action lawsuit was filed in the U.S. District Court for the Southern District of Ohio on behalf of persons who acquired our common shares between February 2, 2012 and April 23, 2012. This lawsuit was filed against us, Lisa Bachmann, Mr. Cooper, Mr. Fishman and Mr. Haubiel. The complaint in the putative class action generally alleges that the defendants made statements concerning our financial performance that were false or misleading. The complaint asserts claims under sections 10(b) and 20(a) of the Securities Exchange Act
of 1934 and Rule 10b-5 and seeks damages in an unspecified amount, plus attorneys' fees and expenses. The lead plaintiff filed an amended complaint on April 4, 2013, which added Mr. Johnson as a defendant, removed Ms. Bachmann as a defendant, and extended the putative class period to August 23, 2012. The defendants have filed a motion to dismiss the putative class action complaint, and that motion is fully briefed and awaiting a decision.

## Table of Contents

We believe that the shareholder derivative and putative class action lawsuits are without merit, and we intend to defend ourselves vigorously against the allegations levied in these lawsuits. While a loss from these lawsuits is reasonably possible, at this time, we cannot reasonably estimate the amount of any loss that may result or whether the lawsuits will have a material impact on our financial statements.

On November 29, 2012, we received a grand jury subpoena from the U.S. Attorney for the Southern District of New York requesting documents relating to Mr. Fishman's trades in our common shares. We provided information in response to the subpoena in late 2012 and early 2013. Since that time, we have received no further subpoena or other request for information from the U.S. Attorney.

On December 7, 2012, we received a voluntary document request from the SEC relating to our guidance for the first quarter of fiscal 2012, internal policies, trading in our common shares by our directors and officers, and the terms of employment with Mr. Fishman. We provided information in response to the SEC request in late 2012 and early 2013. On May 20, 2013, our counsel received a letter dated May 9, 2013, from the Division of Enforcement of the SEC, which stated in relevant part: "This investigation has been completed as to your client, Big Lots, against which we do not intend to recommend any enforcement action by the Commission."

On June 13, 2013, we received a separate voluntary document request from the Division of Enforcement of the SEC relating principally to our participation in investor and analyst meetings in the first fiscal quarter of 2012. We have produced documents and are cooperating with the SEC in connection with its request.

On December 21, 2012, we received a letter from NYSE Regulation requesting information relating to Mr. Fishman's trades in our common shares, internal policies, and the inquiries being conducted by other bodies. We provided information in response to the NYSE Regulation request in early 2013. NYSE Regulation has made additional requests for information and we have cooperated with its requests.

We received a letter dated January 28, 2013, sent on behalf of a shareholder demanding that our Board of Directors investigate and take action in connection with the allegations made in the derivative and securities lawsuits described above. The shareholder indicated that he will commence a derivate lawsuit if our Board of Directors fails to take the demanded action. On March 6, 2013, our Board of Directors referred the shareholder's letter to a committee of independent directors to investigate the matter. That committee, with the assistance of independent outside counsel, investigated the allegations in the shareholder's demand letter and, on August 28, 2013, reported its findings to our Board of Directors along with its recommendation that the Board reject the shareholder's demand. Our Board of Directors unanimously accepted the recommendation of the demand investigation committee and, on September 9, 2013, outside counsel for the committee sent a letter to counsel for the shareholder informing the shareholder of the Board's determination.

We are involved in other legal actions and claims arising in the ordinary course of business. We currently believe that each such action and claim will be resolved without a material effect on our financial condition, results of operations, or liquidity. However, litigation involves an element of uncertainty. Future developments could cause these actions or claims to have a material effect on our financial condition, results of operations, and liquidity.

## Table of Contents

## NOTE 9 - BUSINESS SEGMENT DATA

We manage our business as two segments: U.S. and Canada. The following tables summarize net sales, results of operations, and total assets, by segment:

| (In thousands) | Thirteen Weeks Ended August 3, 2013 |  |  |  | July 28, 2012 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | U.S. | Canada |  | Total | U.S. | Canada |  | Total |
| Net sales | \$1,187,677 | \$37,895 |  | \$ 1,225,572 | \$ 1,183,023 | \$35,014 |  | \$1,218,037 |
| Depreciation expense | 27,570 | 579 |  | 28,149 | 25,468 | 803 |  | 26,271 |
| Operating profit (loss) | 36,544 | (3,733 | ) | 32,811 | 42,627 | (3,283 | ) | 39,344 |
| Interest expense | (730 | ) $(3$ | ) | (733 ) | ) (895 | - |  | (895 |
| Other income (expense) | (11 | ) (107 | ) | (118 | ) - | (38 | ) | (38 |
| Income (loss) from continuing operations before income taxes | 35,803 | (3,843 | ) | 31,960 | 41,732 | (3,321 | ) | 38,411 |
| Income tax expense | 13,835 | - |  | 13,835 | 16,321 | - |  | 16,321 |
| Income (loss) from continuing operations | \$21,968 | \$(3,843 | ) | \$18,125 | \$25,411 | \$(3,321 | ) | \$22,090 |
| (In thousands) | Twenty-Six Weeks Ended |  |  |  | July 28, 201 |  |  |  |
|  | U.S. | Canada |  | Total | U.S. | Canada |  | Total |
| Net sales | \$2,462,421 | \$74,489 |  | \$2,536,910 | \$2,445,258 | \$67,260 |  | \$2,512,518 |
| Depreciation expense | 54,450 | 1,169 |  | 55,619 | 49,892 | 1,667 |  | 51,559 |
| Operating profit (loss) | 97,534 | (8,031 | ) | 89,503 | 117,622 | (9,436 | ) | 108,186 |
| Interest expense | (1,456 | ) $(3$ | ) | (1,459 ) | ) $(1,231$ | - |  | (1,231 |
| Other income (expense) | (11 | ) $(253$ | ) | (264 ) | ) - | (1 | ) | (1 |
| Income (loss) from continuing operations before income taxes | 96,067 | (8,287 | ) | 87,780 | 116,391 | (9,437 | ) | 106,954 |
| Income tax expense | 37,322 | - |  | 37,322 | 44,084 | - |  | 44,084 |
| Income (loss) from continuing operations | \$58,745 | \$(8,287 | ) | \$50,458 | \$72,307 | \$(9,437 | ) | \$62,870 |
| (In thousands) | August 3, 2013 |  |  |  | February 2, 2013 |  |  |  |
|  | U.S. | Canada |  | Total | U.S. | Canada |  | Total |
| Total assets | \$1,738,124 | \$63,187 |  | \$ 1,801,311 | \$ 1,681,005 | \$72,621 |  | \$1,753,626 |
| 15 |  |  |  |  |  |  |  |  |

## Table of Contents

Our U.S. segment uses the following seven merchandise categories, which match our internal management and reporting of merchandise net sales: Food, Consumables, Furniture, Home, Seasonal, Hardlines \& Toys, and Electronics \& Other. The Food category includes our food and beverage departments. The Consumables category includes the health and beauty care, housekeeping supplies, household chemicals, paper products, pet and home organization departments. The Furniture category includes the upholstery, mattresses, ready-to-assemble, and casegoods departments. Casegoods consist of bedroom, dining room, fireplaces, and other occasional furniture. The Home category includes the domestics, stationery, and home decorative departments. The Seasonal category includes the lawn \& garden, Christmas, summer, and other holiday departments. The Hardlines \& Toys category includes the toys, appliances, tools, paint, and home maintenance departments. The Electronics \& Other category includes the electronics, jewelry, infant accessories, and apparel departments, as well as the results of certain large closeout deals that we typically acquire through our alternate product sourcing operations. In the fourth quarter of 2012, we realigned the merchandise categories reported in our U.S. segment to be consistent with the realignment of our merchandising team. Please see the Reclassifications section of note 1 to the consolidated financial statements for further discussion.

The following is net sales data by segment and category:

|  | Second Quarter |  |  |  |
| :--- | :--- | :--- | :--- | :--- |
| (In thousands) | 2013 | 2012 | Year-to-Date <br> 2013 | 2012 |
| U.S. |  |  |  |  |
| $\quad$ Consumables | $\$ 224,222$ | $\$ 218,304$ | $\$ 431,643$ | $\$ 418,326$ |
| $\quad$ Seasonal | 200,648 | 194,472 | 379,464 | 367,877 |
| Furniture | 197,920 | 181,619 | 501,674 | 468,523 |
| Home | 172,889 | 178,260 | 358,666 | 369,437 |
| Food | 167,933 | 169,892 | 344,257 | 347,803 |
| $\quad$ Hardlines \& Toys | 122,064 | 127,650 | 228,671 | 245,435 |
| $\quad$ Electronics \& Other | 102,001 | 112,826 | 218,046 | 227,857 |
| $\quad$ Total U.S. | $1,187,677$ | $1,183,023$ | $2,462,421$ | $2,445,258$ |
| Canada | 37,895 | 35,014 | 74,489 | 67,260 |
| Net sales | $\$ 1,225,572$ | $\$ 1,218,037$ | $\$ 2,536,910$ | $\$ 2,512,518$ |

## Table of Contents

## NOTE 10 - COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table summarizes the components of accumulated other comprehensive loss, net of tax, during 2012 and 2013:

| (In thousands) | Foreign currency translation |  | Pension Plan |  | Total accumulated other comprehensive loss |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Balance at January 28, 2012 | \$ (1,050 | ) | \$ (14,469 | ) | \$ 15,519 |
| Other comprehensive income before reclassifications | (255 | ) | 156 |  | (99 |
| Amounts reclassified from accumulated other comprehensive loss | - |  | 705 |  | 705 |
| Net period change | (255 | ) | 861 |  | 606 |
| Balance at July 28, 2012 | (1,305 | ) | (13,608 | ) | (14,913 |
| Other comprehensive income before reclassifications | (128 | ) | 1,013 |  | 885 |
| Amounts reclassified from accumulated other comprehensive loss | - |  | 698 |  | 698 |
| Net period change | (128 | ) | 1,711 |  | 1,583 |
| Balance at February 2, 2013 | (1,433 | ) | (11,897 | ) | (13,330 |
| Other comprehensive income before reclassifications | (1,965 | ) | - |  | (1,965 |
| Amounts reclassified from accumulated other comprehensive loss | - |  | 499 |  | 499 |
| Net period change | (1,965 | ) | 499 |  | (1,466 |
| Balance at August 3, 2013 | \$ 3,398 | ) | \$(11,398 | ) | \$(14,796 |

The following table summarizes the components of accumulated other comprehensive loss, net of tax, during the second quarter of 2012:
$\left.\left.\begin{array}{llll}\text { (In thousands) } & \begin{array}{l}\text { Foreign currency } \\ \text { translation }\end{array} & \text { Pension Plan } & \begin{array}{l}\text { Total accumulated } \\ \text { other comprehensive } \\ \text { loss }\end{array} \\ \begin{array}{l}\text { Balance at April 28, 2012 } \\ \text { Other comprehensive income before } \\ \text { reclassifications }\end{array} & \$(391 & ) & \$(14,057\end{array}\right) \begin{array}{l}\$(14,448\end{array}\right)$

## Table of Contents

The following table summarizes the components of accumulated other comprehensive loss, net of tax, during the second quarter of 2013:
\(\left.$$
\begin{array}{llll}\text { (In thousands) } & \begin{array}{l}\text { Foreign currency } \\
\text { translation }\end{array} & \text { Pension Plan } & \begin{array}{l}\text { Total accumulated } \\
\text { other comprehensive } \\
\text { loss }\end{array}
$$ <br>

Balance at May 4, 2013 \& \$(2,008 \& ) \& \$(11,646\end{array}\right)\)| $\$(13,654$ |
| :--- |
| Other comprehensive income before <br> reclassifications |
| Amounts reclassified from accumulated <br> other comprehensive loss |
| Net period change <br> Balance at August 3, 2013 |

NOTE 11 - GOODWILL
The changes in the carrying amount of goodwill, which are generally not deductible for income tax purposes, were as follows:

| (In thousands) | 2013 | 2012 |
| :--- | :--- | :--- |
| Beginning of year | $\$ 13,522$ | $\$ 12,282$ |
| Goodwill adjustments | - | 1,191 |
| Foreign currency impact | $(531$ | $)(45$ |
| End of period | $\$ 12,991$ | $\$ 13,428$ |

The goodwill adjustments in 2012 were associated with our acquisition of Big Lots Canada in the second quarter of 2011, and primarily related to fair value adjustments on our intangible assets and liabilities associated with the acquired operating leases.

In the second quarter of 2013, we performed our annual impairment review of goodwill, which resulted in no impairment.

## Table of Contents

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

## CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The Private Securities Litigation Reform Act of 1995 ("Act") provides a safe harbor for forward-looking statements to encourage companies to provide prospective information, so long as those statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed in the statements. We wish to take advantage of the "safe harbor" provisions of the Act.

Certain statements in this report are forward-looking statements within the meaning of the Act, and such statements are intended to qualify for the protection of the safe harbor provided by the Act. The words "anticipate," "estimate," "expect," "objective," "goal," "project," "intend," "plan," "believe," "will," "should," "may," "target," "forecast," "guidance," expressions generally identify forward-looking statements. Similarly, descriptions of our objectives, strategies, plans, goals or targets are also forward-looking statements. Forward-looking statements relate to the expectations of management as to future occurrences and trends, including statements expressing optimism or pessimism about future operating results or events and projected sales, earnings, capital expenditures and business strategy. Forward-looking statements are based upon a number of assumptions concerning future conditions that may ultimately prove to be inaccurate. Forward-looking statements are and will be based upon management's then-current views and assumptions regarding future events and operating performance, and are applicable only as of the dates of such statements. Although we believe the expectations expressed in forward-looking statements are based on reasonable assumptions within the bounds of our knowledge, forward-looking statements, by their nature, involve risks, uncertainties and other factors, any one or a combination of which could materially affect our business, financial condition, results of operations or liquidity.

Forward-looking statements that we make herein and in other reports and releases are not guarantees of future performance and actual results may differ materially from those discussed in such forward-looking statements as a result of various factors, including, but not limited to, the current economic and credit conditions, the cost of goods, our inability to successfully execute strategic initiatives, competitive pressures, economic pressures on our customers and us, the availability of brand name closeout merchandise, trade restrictions, freight costs, operating in Canada, the risks discussed in the Risk Factors section of our most recent Annual Report on Form 10-K, and other factors discussed from time to time in our other filings with the SEC, including Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. This report should be read in conjunction with such filings, and you should consider all of these risks, uncertainties and other factors carefully in evaluating forward-looking statements.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date they are made. We undertake no obligation to publicly update forward-looking statements whether as a result of new information, future events or otherwise. Readers are advised, however, to consult any further disclosures we make on related subjects in our public announcements and SEC filings.

## Table of Contents

## OVERVIEW

The discussion and analysis presented below should be read in conjunction with the accompanying consolidated financial statements and related notes. Each term defined in the notes has the same meaning in this item and the balance of this report.

We are North America's largest broadline closeout retailer, and manage our business as two segments: U.S. and Canada. The following are the results from the second quarter of 2013 that we believe are key indicators of both our consolidated and segment operating performance when compared to the second quarter of 2012:

Consolidated Highlights
Net sales increased $\$ 7.5$ million or $0.6 \%$.
Diluted earnings per share from continuing operations decreased from $\$ 0.36$ per share to $\$ 0.31$ per share.
Inventory increased by $3.7 \%$ or $\$ 32.6$ million to $\$ 913.7$ million from the second quarter of 2012.

## U.S. Segment Highlights

Net sales increased $\$ 4.7$ million or $0.4 \%$.
Comparable store sales for stores open at least fifteen months decreased $2.2 \%$.
Gross margin dollars decreased $\$ 0.1$ million, while gross margin rate decreased 10 basis points from $39.3 \%$ to $39.2 \%$ of sales.
Selling and administrative expenses increased $\$ 3.9$ million, or $1.0 \%$. As a percentage of net sales, selling and administrative expenses increased 20 basis points to $33.8 \%$.
Operating profit rate decreased 50 basis points to $3.1 \%$.

## Canadian Segment Highlights

Net sales increased $\$ 2.9$ million, or $8.3 \%$.
Operating loss increased $\$ 0.4$ million to $\$ 3.7$ million.
See the discussion and analysis below for additional details regarding our segments' operating results.

## STORES

The following table presents stores opened and closed during the year-to-date 2013 and the year-to-date 2012:
$\left.\begin{array}{llll}\text { 2012 } & \text { U.S. } & \text { Canada } & \text { Total } \\ \quad \text { Stores open at the beginning of the fiscal year } & 1,451 & 82 & 1,533 \\ \quad \text { Stores opened during the period } & 28 & - & 28 \\ \text { Stores closed during the period } & (16 & )(1 & )(17 \\ \quad \text { Stores open at the end of the period } & 1,463 & 81 & 1,544 \\ 2013 & & & \\ \text { Stores open at the beginning of the fiscal year } & 1,495 & 79 & 1,574 \\ \text { Stores opened during the period } & 27 & 1 & 28 \\ \text { Stores closed during the period } & (8 & )(1 & )(9 \\ \quad \text { Stores open at the end of the period } & 1,514 & 79 & 1,593\end{array}\right)$

We continue to expect to have a net increase of five U.S store locations during 2013, but now expect to open 54 new stores and close 49 existing locations in the U.S. during 2013. Additionally, we expect to open two new stores and to rebrand four existing Liquidation World or LW stores under the Big Lots brand in Canada during 2013.

## Table of Contents

## RESULTS OF OPERATIONS

The following table compares components of our consolidated statements of operations as a percentage of net sales at the end of each period:

|  | Second Quarter |  | Year-to-Date |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2013 | 2012 |  | 2013 |  | 2012 |  |
| Net sales | 100.0 | \% 100.0 | \% | 100.0 |  | \% 100.0 | \% |
| Cost of sales (exclusive of depreciation expense shown separately below) | 60.9 | 60.8 |  | 60.7 |  | 60.6 |  |
| Gross margin | 39.1 | 39.2 |  | 39.3 |  | 39.4 |  |
| Selling and administrative expenses | 34.1 | 33.8 |  | 33.5 |  | 33.1 |  |
| Depreciation expense | 2.3 | 2.2 |  | 2.2 |  | 2.1 |  |
| Operating profit | 2.7 | 3.2 |  | 3.5 |  | 4.3 |  |
| Interest expense | (0.1 | ) $(0.1$ | ) | (0.1 |  | (0.0 | ) |
| Other income (expense) | (0.0 | ) $(0.0$ | ) | (0.0 |  | (0.0 | ) |
| Income from continuing operations before income taxes | 2.6 | 3.2 |  | 3.5 |  | 4.3 |  |
| Income tax expense | 1.1 | 1.3 |  | 1.5 |  | 1.8 |  |
| Income from continuing operations | 1.5 | 1.8 |  | 2.0 |  | 2.5 |  |
| Discontinued operations | 0.0 | (0.0 | ) | 0.0 |  | (0.0 | ) |
| Net income | 1.5 | \% 1.8 | \% | 2.0 |  | \% 2.5 | \% |

## Table of Contents

## SECOND QUARTER OF 2013 COMPARED TO SECOND QUARTER OF 2012

## U.S. Segment

## Net Sales

Net sales by merchandise category, as a percentage of total net sales, and net sales change in dollars and percentage from the second quarter of 2013 compared to the second quarter of 2012 were as follows:
Second Quarter

| (\$ in thousands) | 2013 |  | Change |  |  |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Consumables | $\$ 224,222$ | 18.8 | $\%$ | $\$ 218,304$ | 18.4 | $\%$ | $\$ 5,918$ | 2.7 | $\%$ |
| Seasonal | 200,648 | 16.9 |  | 194,472 | 16.4 |  | 6,176 | 3.2 |  |
| Furniture | 197,920 | 16.7 |  | 181,619 | 15.4 |  | 16,301 | 9.0 |  |
| Home | 172,889 | 14.6 |  | 178,260 | 15.1 |  | $(5,371$ | $)(3.0$ | $)$ |
| Food | 167,933 | 14.1 |  | 169,892 | 14.4 |  | $(1,959$ | $)(1.2$ | $)$ |
| Hardlines \& Toys | 122,064 | 10.3 |  | 127,650 | 10.8 |  | $(5,586$ | $)(4.4$ | $)$ |
| Electronics \& Other | 102,001 | 8.6 |  | 112,826 | 9.5 |  | $(10,825$ | $)(9.6$ | $)$ |
| Net sales | $\$ 1,187,677$ | 100.0 | $\%$ | $\$ 1,183,023$ | 100.0 | $\%$ | $\$ 4,654$ | 0.4 | $\%$ |

In the fourth quarter of 2012, we realigned select merchandise categories to be consistent with the realignment of our merchandising team and changes to our management reporting. Prior to the fourth quarter of 2012, we reported sales of our toys, books and sporting goods departments in the Play n' Wear category. We moved the toys, books and sporting goods departments out of the Play n' Wear category and repositioned them in the Hardlines \& Other category. We also moved the results of certain large closeout deals that are typically acquired through our alternate product sourcing operations out of the Hardlines \& Other category and repositioned them in the Play n' Wear category. We subsequently renamed our Hardlines \& Other category to Hardlines \& Toys and renamed our Play n' Wear category to Electronics \& Other. Our Consumables category was also separated into a Food category and a Consumables category. The Consumables category now contains our health and beauty care, housekeeping supplies, household chemicals, paper products, pet, and home organization departments, while the Food category contains our various food and beverage departments. Sales results for the second quarter of 2012 have been reclassified to reflect this realignment.

Net sales increased $\$ 4.7$ million, or $0.4 \%$, to $\$ 1,187.7$ million in the second quarter of 2013 , compared to $\$ 1,183.0$ million in the second quarter of 2012. The increase in net sales was principally due to the net addition of 51 stores since the end of the second quarter of 2012, which increased net sales by $\$ 29.6$ million, partially offset by a $2.2 \%$ decrease in comparable store sales for stores open at least fifteen months, which decreased net sales by $\$ 24.9$ million. During the second quarter of 2013, the Seasonal category experienced increases in both sales dollars and comparable store sales. This increase was a positive change in trend from the first quarter of 2013, as sales of our weather-sensitive merchandise in the lawn \& garden and summer departments increased as cool spring weather conditions improved in many parts of the country. The Furniture category also experienced increases in both sales dollars and comparable store sales during the second quarter of 2013. The increase in the Furniture category was driven primarily by strong upholstery and mattress sales which benefited from focused promotional activities during the second quarter of 2013. The Consumables category also experienced growth, primarily driven by growth in our pet department, which has been allocated additional square footage in our stores from our home organization department. The Food category experienced declines in several departments as we continue to work toward improving the merchandise flow and consistency of product offerings in the Food category. The Home category also experienced declines in most departments as we began transitioning our product offerings to improve the quality of merchandise available for sale. The decrease in Hardlines \& Toys sales was primarily driven by declines in our auto and small appliance departments. The decrease in Electronics \& Other sales was primarily driven by a decrease in electronics sales, particularly in tablets, digital cameras, gaming and DVDs.

Edgar Filing: BIG LOTS INC - Form 10-Q

## Table of Contents

Gross Margin
Gross margin dollars decreased $\$ 0.1$ million to $\$ 465.3$ million for the second quarter of 2013 , compared to $\$ 465.4$ million for the second quarter of 2012. The decrease in gross margin dollars was primarily due to lower gross margin rate, which decreased gross margin dollars by approximately $\$ 1.9$ million, partially offset by an increase in sales, which increased gross margin dollars by approximately $\$ 1.8$ million. Gross margin as a percentage of net sales decreased 10 basis points to $39.2 \%$ in the second quarter of 2013 , compared to $39.3 \%$ in the second quarter of 2012. The gross margin rate decrease principally resulted due to increased markdowns implemented to address the negative impact of the cool spring in 2013 on sales of our weather-sensitive goods, primarily in our Seasonal and Hardlines \& Toys categories.

Selling and Administrative Expenses
Selling and administrative expenses were $\$ 401.2$ million for the second quarter of 2013 , compared to $\$ 397.3$ million for the second quarter of 2012. The increase of $\$ 3.9$ million, or $1.0 \%$, was primarily due to increases in store occupancy expenses of $\$ 5.5$ million, store payroll of $\$ 2.6$ million, general office payroll expenses of $\$ 2.2$ million, and other variable store expenses of $\$ 2.0$ million, partially offset by decreases in share-based compensation expense of $\$ 3.4$ million, health benefits expense of $\$ 2.0$ million, and advertising expense of $\$ 1.9$ million. The increase in store occupancy, payroll, and other variable expenses were the result of a net increase of 51 stores compared to the second quarter of 2012. The increase in general office payroll expenses was primarily driven by annual merit increases combined with executive severance costs. The decrease in share-based compensation expense of $\$ 3.4$ million was primarily driven by the forfeiture of awards related to separation activities during the second quarter of 2013 and a reduction in the equity compensation awarded to Mr. Campisi in 2013, as compared to our prior CEO in 2012. The decrease in health benefits expense was primarily driven by a decrease in the number and severity of large claims in the second quarter of 2013 compared to the second quarter of 2012. Advertising expense decreased as a result of cost savings on print advertising due to improved targeting of circulars.

As a percentage of net sales, selling and administrative expenses increased 20 basis points to $33.8 \%$ for the second quarter of 2013 compared to $33.6 \%$ for the second quarter of 2012.

## Depreciation Expense

Depreciation expense increased $\$ 2.1$ million to $\$ 27.6$ million in the second quarter of 2013 , compared to $\$ 25.5$ million for the second quarter of 2012. The increase was directly related to our new store growth, investments in systems, and capital spending to support and maintain our stores and distribution centers. Depreciation expense as a percentage of sales increased by 10 basis points compared to the second quarter of 2012.

## Canadian Segment

Our Canadian segment's net sales increased $\$ 2.9$ million to $\$ 37.9$ million for the second quarter of 2013 , as compared to $\$ 35.0$ million in the second quarter of 2012 . The increase in net sales was principally due to an $8.3 \%$ increase in comparable store sales for stores open at least fifteen months. Our operating loss increased $\$ 0.4$ million to $\$ 3.7$ million for the second quarter of 2013 compared to $\$ 3.3$ million in the second quarter of 2012.

## Other Performance Factors

## Interest Expense

Interest expense was $\$ 0.7$ million in the second quarter of 2013 , compared to $\$ 0.9$ million in the second quarter of 2012. The decrease was driven by a decrease in borrowings in the second quarter of 2013 and a reduction in our interest rate as a result of the amendment to the 2011 Credit Agreement. We had total average borrowings (including capital leases) of $\$ 130.2$ million in the second quarter of 2013 compared to total average borrowings of $\$ 148.6$ million in the second quarter of 2012. The decrease in total average borrowings was primarily the result of share repurchases

## Edgar Filing: BIG LOTS INC - Form 10-Q

in the second quarter of 2012, whereas there was no such repurchase program in place for the second quarter of 2013.

## Income Taxes

The effective income tax expense rate for the second quarter of 2013 and the second quarter of 2012 for income from continuing operations was $43.3 \%$ and $42.5 \%$, respectively. The higher rate was primarily due to a full valuation allowance relative to the deferred tax benefit of a higher loss generated by our Canadian segment along with its accompanying effect on a significantly lower base of income from continuing operations.

## Table of Contents

## YEAR-TO-DATE 2013 COMPARED TO YEAR-TO-DATE 2012

## U.S. Segment

## Net Sales

Net sales by merchandise category, as a percentage of total net sales, and net sales change in dollars and percentage from the year-to-date 2013 compared to the year-to-date 2012 were as follows:

|  | Year-to-Date |  |  |  |  | 2012 |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| (\$ in thousands) | 2013 |  |  |  |  |  |  |  |  |
| Furniture | $\$ 501,674$ | 20.3 | $\%$ | $\$ 468,523$ | 19.3 | $\%$ | $\$ 33,151$ | 7.1 | $\%$ |
| Consumables | 431,643 | 17.5 |  | 418,326 | 17.1 |  | 13,317 | 3.2 |  |
| Seasonal | 379,464 | 15.4 |  | 367,877 | 15.0 |  | 11,587 | 3.1 |  |
| Home | 358,666 | 14.6 |  | 369,437 | 15.1 |  | $(10,771$ | $)(2.9$ | $)$ |
| Food | 344,257 | 14.0 |  | 347,803 | 14.2 |  | $(3,546$ | $)(1.0$ | $)$ |
| Hardlines \& Toys | 228,671 | 9.3 |  | 245,435 | 10.0 |  | $(16,764$ | $)(6.8$ | $)$ |
| Electronics \& Other | 218,046 | 8.9 |  | 227,857 | 9.3 |  | $(9,811$ | $)(4.3$ | $)$ |
| Net sales | $\$ 2,462,421$ | 100.0 | $\%$ | $\$ 2,445,258$ | 100.0 | $\%$ | $\$ 17,163$ | 0.7 | $\%$ |

As discussed above in the section "Second Quarter of 2013 Compared to Second Quarter of 2012", in the fourth quarter of 2012, we realigned select merchandise categories to be consistent with the realignment of our merchandising team and changes to our management reporting. Sales results for the year-to-date 2012 have been reclassified to reflect this realignment.

Net sales increased $\$ 17.1$ million, or $0.7 \%$, to $\$ 2,462.4$ million in the year-to-date 2013, compared to $\$ 2,445.3$ million in the year-to-date 2012. The increase in net sales was principally due to a net increase of 51 new stores since the end of the second quarter of 2012, which increased net sales by $\$ 76.8$ million, partially offset by a $2.6 \%$ decrease in comparable store sales for stores open at least fifteen months, which decreased net sales by $\$ 59.7$ million. The Furniture category was our strongest performer and had the largest sales gains in the year-to-date 2013, with upholstered items being the primary driver. The sales increase in the Consumables category was led by the pet department with household chemicals, housekeeping supplies, and paper products also contributing to the increase, partially offset by declines in health and beauty care and home organization products. The Consumables category benefited from an increased volume of brand name close-outs early in the year. The increase for the Seasonal category was consistent with the growth in our new stores. Sales in our Food category declined in several departments as we work to improve product flow and assortment in this category. Electronics \& Other decreased due to slow electronics sales, particularly in tablet, digital camera, gaming and DVD sales. Our Home category continues to experience declines in most departments as we began transitioning our product offerings to improve the quality of merchandise available for sale. The decline in the Hardlines \& Toys category was primarily driven by slow automotive and home maintenance sales throughout the year, coupled with a planned reduction in our toys and books offerings.

Based on our year-to-date 2013 results and trends during the first few weeks of August, we expect comparable store sales to be in the range of flat to a decrease of $2 \%$ for the third quarter of 2013. For the fourth quarter of 2013 which includes the holiday selling season, we anticipate comparable store sales to be in the range of flat to an increase of $2 \%$. Additionally, net sales for the fourth quarter of 2013 will be negatively impacted by the lack of a 53 rd week when compared to the fourth quarter of 2012, as fiscal 2013 is a 52-week fiscal year and fiscal 2012 was a 53-week fiscal year.

## Gross Margin

Gross margin dollars increased $\$ 2.0$ million, or $0.2 \%$, to $\$ 968.4$ million for the year-to-date 2013, compared to $\$ 966.4$ million for the year-to-date 2012. The increase in gross margin dollars was principally due to the sales increase of

## Edgar Filing: BIG LOTS INC - Form 10-Q

$\$ 17.1$ million, which increased gross margin dollars by approximately $\$ 6.8$ million, partially offset by a decrease in gross margin rate, which decreased gross margin dollars by approximately $\$ 4.8$ million. Gross margin as a percentage of net sales decreased 20 basis points to $39.3 \%$ in the year-to-date 2013, compared to $39.5 \%$ in the year-to-date 2012. The gross margin rate decrease was principally due to an increase in the volume of markdowns to encourage sales following the cool spring, which negatively impacted our Seasonal and weather-sensitive goods.

24

## Table of Contents

In both the third and fourth quarters of 2013, we expect our gross margin rate will be higher than the third and fourth quarters of 2012, as we expect a lower overall markdown rate in 2013 as compared to 2012 as well as improvements in our merchandise mix.

Selling and Administrative Expenses
Selling and administrative expenses were $\$ 816.4$ million for the year-to-date 2013 , compared to $\$ 798.8$ million for the year-to-date 2012. The increase of $\$ 17.6$ million, or $2.2 \%$, was primarily due to increases in store occupancy expenses of $\$ 10.9$ million, a one-time litigation settlement of $\$ 4.4$ million, store payroll expense of $\$ 3.5$ million, general office payroll expenses of $\$ 2.6$ million, store maintenance and repairs of $\$ 2.4$ million, and bonus expenses of $\$ 2.2$ million, which were partially offset by decreases in share-based compensation expense of $\$ 6.9$ million, and advertising expense of $\$ 2.8$ million. The one-time litigation settlement is the result of a loss contingency for a legal matter that was accrued in the first quarter of 2013 for $\$ 5.1$ million, for which the settlement was finalized in the second quarter of 2013 for $\$ 4.4$ million. The increase in store occupancy and payroll was primarily due to the net increase of 51 stores compared to the year-to-date 2012 . The increase in general office payroll expenses was primarily driven by annual merit increases combined with separation activities that occurred during the second quarter of 2013. The increase in store maintenance and repair expense was primarily driven by annual store updates, such as lighting and floor maintenance, to update their appearance. The increase in bonus expense was directly related to better relative financial performance in the year-to-date 2013 to our annual operating plan as compared to the financial performance during the year-to-date 2012. The decrease in share-based compensation expense was primarily driven by a lower number of share-based awards granted in the year-to-date 2013 compared to the year-to-date 2012, notably as a result of a reduction in the size of the equity compensation package awarded to Mr. Campisi in 2013 as compared to our former CEO in 2012, and the forfeiture of certain awards resulting from the departure of certain members of senior management during the second quarter of 2013. The decrease in advertising expense was primarily driven by cost savings on print advertising due to improved targeting of circulars.

As a percentage of net sales, selling and administrative expenses increased 50 basis points to $33.2 \%$ for the year-to-date 2013 compared to $32.7 \%$ for the year-to-date 2012.

For the third quarter of 2013, we expect our selling and administrative expenses as a percentage of net sales will slightly increase compared to the third quarter of 2012. The anticipated deleverage for the third quarter of 2013 is the result of estimated comparable store sales of flat to a decrease of $2 \%$, as forecasted selling and administrative expense dollars on a per store basis are expected to be slightly up to the third quarter of 2012.

For the fourth quarter of 2013, we anticipate our selling and administrative expenses as a percentage of net sales will increase compared to the fourth quarter of 2012. The primary driver of this increase is anticipated accrued bonus expense in 2013 as compared to 2012 when there was no corporate payout.

## Depreciation Expense

Depreciation expense increased $\$ 4.6$ million to $\$ 54.5$ million in the year-to-date 2013 , compared to $\$ 49.9$ million for the year-to-date 2012. The increase is directly related to our new store growth, investments in systems, and capital spending to support and maintain our stores and distribution centers. Depreciation expense as a percentage of sales increased by 20 basis points compared to the year-to-date 2012.

During the balance of 2013, we expect that depreciation expense will increase as compared to 2012 as a result of our continued investment in capital expenditures associated with new store openings and maintenance of existing stores and distribution centers. Total capital expenditures continue to be forecasted in the range of $\$ 115$ million to $\$ 120$ million for 2013.

Canadian Segment

Our Canadian segment's net sales increased $\$ 7.2$ million to $\$ 74.5$ million in the year-to-date 2013, as compared to $\$ 67.3$ million in the year-to-date 2012. The increase in net sales was principally due to a $10.6 \%$ increase in comparable store sales for stores open at least fifteen months. The increase in comparable store sales was primarily driven by an improvement in inventory levels and assortment in the first quarter of 2013 compared to an inventory deficiency in the first quarter of 2012 as we were working towards establishing sufficient merchandise flow at that time. Our operating loss narrowed $\$ 1.4$ million to $\$ 8.0$ million in the year-to-date 2013 as compared to $\$ 9.4$ million in the year-to-date 2012. Our operating loss narrowed primarily due to an increase in sales and the associated gross margin dollars.

For the full fiscal year of 2013, we estimate sales in the range of $\$ 165$ to $\$ 173$ million, an increase of $7 \%$ to $12 \%$. Comparable store sales are estimated to increase in the range of $7 \%$ to $12 \%$ as well. Based on sales in the above estimated range, we estimate a net loss of $\$ 9$ to $\$ 14$ million for the full fiscal year of 2013.

25

# Edgar Filing: BIG LOTS INC - Form 10-Q 

## Table of Contents

Other Performance Factors

## Interest Expense

Interest expense was $\$ 1.5$ million in the year-to-date 2013, compared to $\$ 1.2$ million in the year-to-date 2012. The increase was driven by higher average borrowings under our bank credit facility, particularly in the earlier part of 2013. We had total average borrowings (including capital leases) of $\$ 125.2$ million in the year-to-date 2013 compared to total average borrowings of $\$ 82.9$ million in the year-to-date 2012.

Income Taxes
The effective income tax rate for the year-to-date 2013 and the year-to-date 2012 for income from continuing operations was $42.5 \%$ and $41.2 \%$, respectively. The lower effective income tax rate for year-to-date 2012 was principally driven by the recognition of income tax benefits associated with state settlement activity that did not occur for the year-to-date 2013, partially offset by favorability in hiring tax credits. The income tax rate differential on the loss generated by our Canadian segment, coupled with the related valuation allowance, increased our effective tax rate by $3.6 \%$ and $3.3 \%$ during the year-to-date 2013 and the year-to-date 2012, respectively.

## Capital Resources and Liquidity

On July 22, 2011, we entered into the 2011 Credit Agreement, and it was amended on May 30, 2013 to lower our interest rates, pricing, and fees and the term was extended from July 22, 2016 to May 30, 2018. In connection with our entry into the 2011 Credit Agreement, we paid bank fees and other expenses in the aggregate amount of $\$ 3.0$ million, which are being amortized over the term of the agreement. In connection with the amendment of the 2011 Credit Agreement, we paid additional bank fees and other expenses in the aggregate amount of $\$ 1.0$ million, which are being amortized over the term of the agreement. Borrowings under the 2011 Credit Agreement are available for general corporate purposes and working capital. The 2011 Credit Agreement includes a $\$ 10$ million Canadian swing loan sublimit, a $\$ 30$ million U.S. swing loan sublimit, a $\$ 150$ million letter of credit sublimit, and a $\$ 200$ million Canadian revolving credit loan subfacility. The interest rates, pricing and fees under the 2011 Credit Agreement fluctuate based on our debt rating. The 2011 Credit Agreement allows us to select our interest rate for each borrowing from multiple interest rate options. The interest rate options are generally derived from the prime rate, LIBOR, or CDOR. We may prepay revolving loans made under the 2011 Credit Agreement. The 2011 Credit Agreement contains financial and other covenants, including, but not limited to, limitations on indebtedness, liens and investments, as well as the maintenance of two financial ratios - a leverage ratio and a fixed charge coverage ratio. A violation of any of the covenants could result in a default under the 2011 Credit Agreement that would permit the lenders to restrict our ability to further access the 2011 Credit Agreement for loans and letters of credit and require the immediate repayment of any outstanding loans under the 2011 Credit Agreement. At August 3, 2013, we were in compliance with the covenants of the 2011 Credit Agreement.

The primary source of our liquidity is cash flows from operations and, as necessary, borrowings under the 2011 Credit Agreement. Our net income and, consequently, our cash provided by operations are impacted by net sales volume, seasonal sales patterns, and operating profit margins. Our net sales are typically highest during the nine-week Christmas selling season in our fourth fiscal quarter. Generally, our working capital requirements peak late in our third fiscal quarter or early in our fourth fiscal quarter. We have typically funded those requirements with borrowings under our credit facility. At August 3, 2013, we had $\$ 141.7$ million in borrowings under the 2011 Credit Agreement and the borrowings available under the 2011 Credit Agreement were $\$ 538.6$ million, after taking into account the reduction in availability resulting from outstanding letters of credit totaling $\$ 19.7$ million. Based on our forecasted results, we anticipate that total indebtedness under the 2011 Credit Agreement through December 15, 2013 will peak at less than $\$ 400$ million, which includes outstanding letters of credit and the estimated impact of cash needs of our Canadian segment.

## Edgar Filing: BIG LOTS INC - Form 10-Q

Cash provided by operating activities decreased by $\$ 6.7$ million to $\$ 82.0$ million in the year-to-date 2013 compared to $\$ 88.7$ million in the year-to-date 2012. The primary cause of the decrease in cash provided by operating activities was the decrease in net income of $\$ 12.3$ million to $\$ 50.5$ million in the year-to-date 2013 from $\$ 62.8$ million in the year-to-date 2012. This decrease was partially offset by an increase in depreciation and amortization of $\$ 2.7$ million to $\$ 49.5$ million in the year-to-date 2013 compared to $\$ 46.8$ million in the year-to-date 2012.

Cash used in investing activities decreased by $\$ 10.2$ million to $\$ 50.1$ million in the year-to-date 2013 compared to $\$ 60.3$ million in the year-to-date 2012. The decrease was primarily driven by a $\$ 9.0$ million reduction in capital expenditures to $\$ 51.7$ million in the year-to-date 2013 compared to $\$ 60.7$ million in the year-to-date 2012. The decrease in capital expenditures is in line with our plan to reduce capital spending in 2013 as compared to 2012.

## Table of Contents

Cash used in financing activities decreased by $\$ 6.8$ million to $\$ 28.4$ million in the year-to-date 2013 compared to $\$ 35.2$ million in the year-to-date 2012. The decrease in the cash used in financing activities was driven by the lack of a share repurchase program in the year-to-date 2013, which accounted for a $\$ 252.6$ million decrease in cash used in financing activities as we repurchased $\$ 252.8$ million in shares during the year-to-date 2012 under a board-authorized share repurchase program. This decrease was partially offset by our repayment of borrowings of $\$ 29.5$ million in the year-to-date 2013 compared to our proceeds from borrowings of $\$ 176.9$ in the year-to-date 2012, which increased the cash used in financing activities by $\$ 206.4$ million. Also contributing to the offset was a reduction in the proceeds from the exercise of stock options of $\$ 30.4$ million.

On a consolidated basis, we expect cash provided by operating activities less capital expenditures to be approximately \$175 million for 2013.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates, judgments, and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period, as well as the related disclosure of contingent assets and liabilities at the date of the financial statements. On an ongoing basis, management evaluates its estimates, judgments, and assumptions, and bases its estimates, judgments, and assumptions on historical experience, current trends, and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. See note 1 to our consolidated financial statements included in our 2012 Form 10-K for additional information about our accounting policies.

The estimates, judgments, and assumptions that have a higher degree of inherent uncertainty and require the most significant judgments are outlined in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our 2012 Form 10-K. Had we used estimates, judgments, and assumptions different from any of those discussed in our 2012 Form 10-K, our financial condition, results of operations, and liquidity for the current period could have been materially different from those presented.

## Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk
We are subject to market risk from exposure to changes in interest rates on investments that we make from time to time and on borrowings under the 2011 Credit Agreement. An increase or decrease of $1 \%$ in interest rates would not have a material effect on our financial condition, results of operations, or liquidity.

We are subject to market risks associated with foreign currency exchange rate fluctuations between the Canadian Dollar and the U.S. Dollar. An increase or decrease of $1 \%$ in foreign currency exchange rates would not have a material effect on our financial condition, results of operations, or liquidity.

Item 4. Controls and Procedures
Evaluation of Disclosure Controls and Procedures
Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have each concluded that such disclosure controls and procedures were effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting
There were no changes in our internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## Table of Contents

Part II. Other Information

## Item 1. Legal Proceedings

No response is required under Item 103 of Regulation S-K. For a discussion of certain litigated matters, see note 8 to the accompanying consolidated financial statements.

Item 1A. Risk Factors
During the second quarter of 2013, there were no material changes to the risk factors previously disclosed in our 2012 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
(In thousands, except price per share data)

| Period | (a) Total <br> Number of <br> Shares <br> Purchased | (b) Average Price Paid per Share | (c) Total |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  |  | Number of |  |
|  |  |  | Shares | Dollar Value of |
|  |  |  | Purchased as Part of | Shares that May <br> Yet Be |
|  |  |  | Publicly | Purchased |
|  |  |  | Announced | Under the Plans |
|  |  |  | Plans or | or Programs |
|  |  |  | Programs |  |
| May 5, 2013 - June 1, 2013 | - | \$- | - | \$- |
| June 2, 2013 - June 29, 2013 | - | - | - | - |
| June 30, 2013 - August 3, 2013 | 6 | 33.83 | - | - |
| Total | 6 | \$33.83 | - | \$- |

In July 2013, in connection with the vesting of certain outstanding restricted shares, we acquired 6,336 of our common shares, which were withheld to satisfy minimum statutory income tax withholdings.

Item 3. Defaults Upon Senior Securities

None.

## Table of Contents

Item 4. Mine Safety Disclosures
None.
Item 5. Other Information

None.

Item 6. Exhibits
Exhibits marked with an asterisk $\left({ }^{*}\right)$ are filed herewith. The Exhibit marked with two asterisks $\left({ }^{* *}\right)$ is furnished electronically with this Quarterly Report.

Exhibit No. Document
31.1* Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*

Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*

Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2* Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101** XBRL Instance Document.

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

Dated: September 10, 2013
BIG LOTS, INC.
By: /s/ Timothy A. Johnson
Timothy A. Johnson
Senior Vice President and Chief Financial Officer
(Principal Financial Officer, Principal Accounting Officer and Duly Authorized Officer)

