Zumiez Inc
Form 10-Q
September 08, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JULY 30, 2016

OR

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

Commission file number 000-51300

ZUMIEZ INC.

(Exact name of registrant as specified in its charter)

Washington	**91-1040022**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

4001 204th Street SW, Lynnwood, WA 98036

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: (425) 551-1500

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 x 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 x No ¨

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨

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

At August 31, 2016, there were 24,830,885 shares outstanding of common stock.

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ZUMIEZ INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	July 30, 2016 (Unaudited)	January 30, 2016
Assets		
Current assets		
Cash and cash equivalents	$ 19,600	$ 43,163
Marketable securities	32,740	32,391
Receivables	14,576	12,840
Inventories	131,823	98,299
Prepaid expenses and other current assets	13,990	12,204
Total current assets	212,729	198,897
Fixed assets, net	136,505	137,233
Goodwill	55,082	54,245
Intangible assets, net	12,005	11,766
Deferred tax assets, net	8,332	4,634
Other long-term assets	7,908	7,920
Total long-term assets	219,832	215,798
Total assets	$ 432,561	$ 414,695
Liabilities and Shareholders Equity		
Current liabilities		
Trade accounts payable	$ 60,044	$ 21,919
Accrued payroll and payroll taxes	12,754	12,466
Income taxes payable	507	4,066
Deferred rent and tenant allowances	8,384	8,116
Other liabilities	22,089	22,575
Total current liabilities	103,778	69,142
Long-term deferred rent and tenant allowances	43,721	43,779
Other long-term liabilities	4,815	4,817
Total long-term liabilities	48,536	48,596
Total liabilities	152,314	117,738
Commitments and contingencies (Note 3)		
Shareholders equity		

Preferred stock, no par value, 20,000 shares authorized; none issued and outstanding				
Common stock, no par value, 50,000 shares authorized; 24,931 shares issued and outstanding at July 30, 2016 and 25,708 shares issued and outstanding at January 30, 2016		137,102		135,013
Accumulated other comprehensive loss		(12,802)		(15,247)
Retained earnings		155,947		177,191
Total shareholders equity		280,247		296,957
Total liabilities and shareholders equity	$	432,561	$	414,695

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

CONDENSED CONSOLIDATED STATEMENTS OF (LOSS) INCOME

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 30, 2016	**August 1, 2015**	**July 30, 2016**	**August 1, 2015**
Net sales	$ 178,272	$ 179,819	$ 351,243	$ 357,429
Cost of goods sold	123,428	122,046	246,440	243,121
Gross profit	54,844	57,773	104,803	114,308
Selling, general and administrative expenses	55,980	52,461	109,879	104,870
Operating (loss) profit	(1,136)	5,312	(5,076)	9,438
Interest income, net	28	150	59	355
Other (expense) income, net	(256)	(271)	242	(156)
(Loss) earnings before income taxes	(1,364)	5,191	(4,775)	9,637
(Benefit) provision for income taxes	(526)	1,978	(1,800)	3,654
Net (loss) income	$ (838)	$ 3,213	$ (2,975)	$ 5,983
Basic (loss) earnings per share	$ (0.03)	$ 0.11	$ (0.12)	$ 0.21
Diluted (loss) earnings per share	$ (0.03)	$ 0.11	$ (0.12)	$ 0.21
Weighted average shares used in computation of (loss) earnings per share:				
Basic	24,712	28,311	24,957	28,726
Diluted	24,712	28,439	24,957	28,932

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net (loss) income	$ (838)	$ 3,213	$ (2,975)	$ 5,983
Other comprehensive (loss) income, net of tax and reclassification adjustments:				
Foreign currency translation	(2,664)	(2,207)	2,329	(2,675)
Net change in unrealized gain/loss on available-for-sale securities	122	(28)	116	(49)
Other comprehensive (loss) income, net	(2,542)	(2,235)	2,445	(2,724)
Comprehensive (loss) income	**$ (3,380)**	**$ 978**	**$ (530)**	**$ 3,259**

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(In thousands)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Accumulated Other Comprehensive Loss	Retained Earnings	Total
Balance at January 30, 2016	25,708	$ 135,013	$ (15,247)	$ 177,191	$ 296,957
Net loss				(2,975)	(2,975)
Other comprehensive income, net			2,445		2,445
Issuance and exercise of stock-based awards, including net tax loss of $529	282	(132)			(132)
Stock-based compensation expense		2,221			2,221
Repurchase of common stock	(1,059)			(18,269)	(18,269)
Balance at July 30, 2016	24,931	$ 137,102	$ (12,802)	$ 155,947	$ 280,247

	Common Stock Shares	Common Stock Amount	Accumulated Other Comprehensive Loss	Retained Earnings	Total
Balance at January 31, 2015	29,418	$ 129,094	$ (11,278)	$ 241,708	$ 359,524
Net income				5,983	5,983
Other comprehensive loss, net			(2,724)		(2,724)
Issuance and exercise of stock-based awards, including net tax benefit of $713	225	575			575
Stock-based compensation expense		2,710			2,710
Repurchase of common stock	(2,266)			(60,950)	(60,950)
Balance at August 1, 2015	27,377	$ 132,379	$ (14,002)	$ 186,741	$ 305,118

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended	
	July 30, 2016	**August 1, 2015**
Cash flows from operating activities:		
Net (loss) income	$ (2,975)	$ 5,983
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation, amortization and accretion	14,336	15,644
Deferred taxes	(3,713)	(2,703)
Stock-based compensation expense	2,221	2,710
Excess tax benefit from stock-based compensation		(713)
Other	95	626
Changes in operating assets and liabilities:		
Receivables	(842)	(3,377)
Inventories	(32,766)	(28,990)
Prepaid expenses and other current assets	(2,690)	(1,306)
Trade accounts payable	38,181	15,684
Accrued payroll and payroll taxes	225	(1,613)
Income taxes payable	(4,804)	(2,996)
Deferred rent and tenant allowances	(12)	2,976
Other liabilities	(813)	(948)
Net cash provided by operating activities	6,443	977
Cash flows from investing activities:		
Additions to fixed assets	(11,895)	(20,021)
Purchases of marketable securities and other investments	(28,353)	(38,238)
Sales and maturities of marketable securities and other investments	28,658	112,093
Net cash (used in) provided by investing activities	(11,590)	53,834
Cash flows from financing activities:		
Proceeds from revolving credit facilities		20,223
Payments on revolving credit facilities		(15,617)
Repurchase of common stock	(19,084)	(58,969)
Proceeds from exercise of stock-based awards, net of withholding tax	397	379
Excess tax benefit from stock-based compensation		713
Net cash used in financing activities	(18,687)	(53,271)

Effect of exchange rate changes on cash and cash equivalents	271	(236)
Net (decrease) increase in cash and cash equivalents	(23,563)	1,304
Cash and cash equivalents, beginning of period	43,163	20,862
Cash and cash equivalents, end of period	$ 19,600	$ 22,166
Supplemental disclosure on cash flow information:		
Cash paid during the period for income taxes	$ 6,736	$ 14,581
Accrual for purchases of fixed assets	1,835	3,107
Accrual for repurchase of common stock	254	1,981

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Business and Basis of Presentation

Nature of Business Zumiez Inc., including its wholly owned subsidiaries, (the Company, we, us, its and our) is leading specialty retailer of apparel, footwear, accessories and hardgoods for young men and women who want to express their individuality through the fashion, music, art and culture of action sports, streetwear, and other unique lifestyles. At July 30, 2016, we operated 673 stores; 604 in the United States (U.S.), 44 in Canada and 25 in Europe. We operate under the names Zumiez and Blue Tomato. Additionally, we operate ecommerce websites at www.zumiez.com and www.blue-tomato.com.

Fiscal Year We use a fiscal calendar widely used by the retail industry that results in a fiscal year consisting of a 52- or 53-week period ending on the Saturday closest to January 31. Each fiscal year consists of four 13-week quarters, with an extra week added to the fourth quarter every five or six years. The three months ended July 30, 2016 and August 1, 2015 were 13-week periods. The six months ended July 30, 2016 and August 1, 2015 were 26-week periods.

Basis of Presentation The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of Zumiez Inc. and its wholly-owned subsidiaries. All significant intercompany transactions and balances are eliminated in consolidation.

In our opinion, the unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the condensed consolidated balance sheets, operating results and cash flows for the periods presented.

The financial data at January 30, 2016 is derived from audited consolidated financial statements, which are included in our Annual Report on Form 10-K for the year ended January 30, 2016, and should be read in conjunction with the audited consolidated financial statements and notes thereto. Interim results are not necessarily indicative of results for the full fiscal year due to seasonality and other factors.

Use of Estimates The preparation of financial statements in conformity with U.S. GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements as well as the reported amounts of revenues and expenses during the reporting period. These estimates can also affect supplemental information disclosed by us, including information about contingencies, risk and financial condition. Actual results could differ from these estimates and assumptions.

Segment Reporting We identify our operating segments according to how our business activities are managed and evaluated. Our operating segments have been aggregated and are reported as one reportable segment based on the similar nature of products sold, production, merchandising and distribution processes involved, target customers and economic characteristics.

Recent Accounting Standards In March 2016, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) as part of its simplification initiative that includes multiple provisions intended to simplify various aspects of the accounting for share-based payments. Upon the adoption of the ASU, excess tax benefits and deficiencies for share-based payments are recorded as an adjustment of income taxes and reflected in operating cash flows rather than recorded in equity and reported in financing cash flows. The guidance allows for the employer to withhold up to the maximum statutory tax rates in the applicable jurisdictions without triggering liability accounting. The guidance also allows for a policy election to account for forfeitures as they occur rather than on an estimated basis. The new standard is effective for the fiscal year beginning after December 15, 2016, with early adoption permitted. We are evaluating the impact of this standard on our condensed consolidated financial statements.

In February 2016, the FASB issued a comprehensive standard related to lease accounting to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Most significantly, the new guidance requires lessees to recognize operating leases with a term of more than 12 months as lease assets and lease liabilities. The adoption will require a modified retrospective approach at the beginning of the earliest period presented. The new standard is effective for the fiscal year beginning after December 15, 2018, with early adoption permitted. We are evaluating the impact of this standard on our condensed consolidated financial statements.

In January 2016, the FASB issued a new standard related primarily to accounting for equity investments, financial liabilities where the fair value option has been elected, and the presentation and disclosure requirements for financial instruments. There will no longer be an available-for-sale classification and therefore, no changes in fair value will be reported in other comprehensive income for equity securities with readily determinable fair values. The new standard will be effective for the fiscal year beginning after December 15, 2017 and early adoption is permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In July 2015, the FASB issued guidance simplifying the measurement of inventory. This standard requires entities that use inventory methods other than the last-in, first-out (LIFO) or retail inventory method to measure inventory at the lower of cost or net realizable value, which is defined as the estimated selling prices in the normal course of business, less reasonably predictable costs of completion, disposal, and transportation. We are required to adopt this guidance for the fiscal year beginning after December 31, 2016. We are currently evaluating the impact of this standard on our condensed consolidated financial statements.

In April 2015, the FASB issued guidance about a customer s accounting for fees paid in a cloud computing arrangement. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance is effective for the fiscal year beginning after December 15, 2015 and may be applied on either a prospective or retrospective basis. We adopted this guidance beginning in the first quarter ending July 30, 2016 and the adoption did not have a material impact on our condensed consolidated financial statements.

In May 2014, the FASB issued a comprehensive new revenue recognition standard. The new standard allows for a full retrospective approach to transition or a modified retrospective approach. This guidance was effective for fiscal years and interim periods within those years beginning after December 15, 2016. In August 2015, the FASB issued updated guidance deferring the effective date for the fiscal year beginning after December 15, 2017 and will permit early adoption of the standard, but not before the original effective date of December 15, 2016. We are currently evaluating the method of adoption we plan to use and the effect the standard is expected to have on our condensed consolidated financial statements.

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2. Cash, Cash Equivalents and Marketable Securities

The following tables summarize the estimated fair value of our cash, cash equivalents and marketable securities and the gross unrealized holding gains and losses (in thousands):

	July 30, 2016			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	$ 18,947	$	$	$ 18,947
Money market funds	653			653
Total cash and cash equivalents	19,600			19,600
Marketable securities:				
State and local government securities	31,087	21	(13)	31,095
Variable-rate demand notes	1,645			1,645
Total marketable securities	$ 32,732	$ 21	$ (13)	$ 32,740

	January 30, 2016			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	$ 33,608	$	$	$ 33,608
Money market funds	9,555			9,555
Total cash and cash equivalents	43,163			43,163
Marketable securities:				
State and local government securities	32,754	8	(187)	32,575
Variable-rate demand notes	644			644
Total marketable securities	$ 33,398	$ 8	$ (187)	$ 33,219
Less: Long-term marketable securities (1)				(828)
Total current marketable securities				$ 32,391

(1) At January 30, 2016, we held one auction rate security, classified as available-for-sale marketable securities and included in other long-term assets on the condensed consolidated balance sheet.

All of our available-for-sale securities have an effective maturity date of two years or less and may be liquidated, at our discretion, prior to maturity.

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The following tables summarize the gross unrealized holding losses and fair value for investments in an unrealized loss position, and the length of time that individual securities have been in a continuous loss position (in thousands):

	July 30, 2016					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Marketable securities:						
State and local government securities	5,068	(12)	305	(1)	5,373	(13)
Total marketable securities	$ 5,068	$ (12)	$ 305	$ (1)	$ 5,373	$ (13)

	January 30, 2016					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Marketable securities:						
State and local government securities	16,884	(15)	853	(172)	17,737	(187)
Total marketable securities	$ 16,884	$ (15)	$ 853	$ (172)	$ 17,737	$ (187)

We did not record a realized loss for other-than-temporary impairments during the three and six months ended July 30, 2016 or August 1, 2015.

3. Commitments and Contingencies

Leases We lease our stores and certain corporate and other operating facilities under operating leases. Total rent expense is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Minimum rent expense	$ 18,409	$ 17,050	$ 36,410	$ 33,944
Contingent rent expense	459	402	873	739
Total rent expense (1)	$ 18,868	$ 17,452	$ 37,283	$ 34,683

(1) Total rent expense does not include real estate taxes, insurance, common area maintenance charges and other executory costs, which were $10.3 million and $20.5 million for the three and six months ended July 30, 2016 and $9.6 million and $19.0 million for the three and six months ended August 1, 2015.

A majority of our leases provide for ongoing co-tenancy requirements or early cancellation clauses that would further lower rental rates, or permit lease terminations, or both, in the event that co-tenants cease to operate for specific periods or if certain sales levels are not met in specific periods. Most of the store leases require payment of a specified minimum rent and a contingent rent based on a percentage of the store s net sales in excess of a specified threshold, as well as real estate taxes, insurance, common area maintenance charges and other executory costs. Future minimum lease payments at July 30, 2016 are as follows (in thousands):

Fiscal 2016	$ 34,708
Fiscal 2017	65,954
Fiscal 2018	61,022
Fiscal 2019	54,155
Fiscal 2020	50,182
Thereafter	157,338
Total (1)	$ 423,359

(1) Amounts in the table do not include contingent rent and real estate taxes, insurance, common area maintenance charges and other executory costs obligations.

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Purchase Commitments At July 30, 2016, we had outstanding purchase orders to acquire merchandise from vendors of $167.6 million. We have an option to cancel these commitments with no notice prior to shipment, except for certain private label and international purchase orders in which we are obligated to repay contractual amounts upon cancellation.

Litigation We are involved from time to time in claims, proceedings and litigation arising in the ordinary course of business. We have made accruals with respect to these matters, where appropriate, which are reflected in our condensed consolidated financial statements. For some matters, the amount of liability is not probable or the amount cannot be reasonably estimated and therefore accruals have not been made. We may enter into discussions regarding settlement of these matters, and may enter into settlement agreements, if we believe settlement is in the best interest of our shareholders.

Insurance Reserves We use a combination of third-party insurance and self-insurance for a number of risk management activities including workers compensation, general liability and employee-related health care benefits. We maintain reserves for our self-insured losses, which are estimated based on historical claims experience and actuarial and other assumptions. The self-insurance reserve at July 30, 2016 and January 30, 2016 was $2.5 million and $2.1 million.

4. Revolving Credit Facilities and Debt

On February 5, 2016, the Company entered into an asset-based revolving credit agreement with Wells Fargo Bank, National Association, which provides for a senior secured revolving credit facility of up to $100 million (ABL Facility), subject to a borrowing base, with a letter of credit sub-limit of $10 million. The ABL Facility is available for working capital and other general corporate purposes. The ABL Facility replaced our $25.0 million secured revolving credit facility with Wells Fargo, which was entered into on July 9, 2014 and was scheduled to expire on September 1, 2016. The ABL Facility will mature on February 5, 2021.

The ABL Facility is secured by a first-priority security interest in substantially all of the personal property (but not the real property) of the borrowers and guarantors. Amounts borrowed under the ABL Facility bear interest, at the Company s option, at either an adjusted LIBOR rate plus a margin of 1.25% to 1.75% per annum, or an alternate base rate plus a margin of 0.25% to 0.75% per annum. The Company is also required to pay a fee of 0.25% per annum on undrawn commitments under the ABL Facility. Customary agency fees and letter of credit fees are also payable in respect of the ABL Facility.

Additionally, we have revolving lines of credit of up to 7.3 million Euro, the proceeds of which are used to fund certain international operations. The revolving lines of credit bear interest at 1.65%-3.00%. On August 12, 2016, the revolving lines of credit were increased to 20.5 million Euro.

There were no borrowings outstanding under any revolving lines of credit at July 30, 2016 and January 30, 2016. We had $0.3 million in open commercial letters of credit outstanding under these lines of credit at July 30, 2016 and no open commercial letters of credit outstanding at January 30, 2016.

5. Fair Value Measurements

We apply the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1	Quoted prices in active markets for identical assets or liabilities;
Level 2	Quoted prices for similar assets or liabilities in active markets or inputs that are observable; and
Level 3	Inputs that are unobservable.

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The following tables summarize assets measured at fair value on a recurring basis (in thousands):

	July 30, 2016		
	Level 1	Level 2	Level 3
Cash equivalents:			
Money market funds	$ 653	$	$
Marketable securities:			
State and local government securities		31,095	
Variable-rate demand notes		1,645	
Other long term assets:			
Money market funds	2,110		
Equity investments			121
Total	$ 2,763	$ 32,740	$ 121

	January 30, 2016		
	Level 1	Level 2	Level 3
Cash equivalents:			
Money market funds	$ 9,555	$	$
Marketable securities:			
State and local government securities		31,747	
Variable-rate demand notes		644	
Other long term assets:			
Money market funds	1,510		
State and local government securities			828
Equity investments			118
Total	$ 11,065	$ 32,391	$ 946

The Level 2 marketable securities primarily include state and local municipal securities and variable-rate demand notes. Fair values are based on quoted market prices for similar assets or liabilities or determined using inputs that use readily observable market data that are actively quoted and can be validated through external sources, including third-party pricing services, brokers and market transactions. We review the pricing techniques and methodologies of the independent pricing service for Level 2 investments and believe that its policies adequately consider market activity, either based on specific transactions for the security valued or based on modeling of securities with similar credit quality, duration, yield and structure that were recently traded. We monitor security-specific valuation trends and we make inquiries with the pricing service about material changes or the absence of expected changes to understand the underlying factors and inputs and to validate the reasonableness of the pricing.

There were no material assets measured at fair value on a nonrecurring basis for the three and six months ended July 30, 2016 and August 1, 2015.

6. Stockholders Equity

Share Repurchase In December 2014, our Board of Directors authorized us to repurchase $30.0 million shares of our common stock. This superseded and replaced any previously authorized share repurchase program. In June 2015, our Board of Directors superseded and replaced this program with a $50.0 million share repurchase program that was completed in August 2015. In December 2015, our Board of Directors authorized us to repurchase up to $70.0 million of our common stock. This program is expected to continue through January 28, 2017, unless the time period is extended or shortened by the Board of Directors.

The following table summarizes common stock repurchase activity during the six months ended July 30, 2016 (in thousands, except per share amounts):

Number of shares repurchased	1,059
Average price per share of repurchased shares (with commission)	$ 17.25
Total cost of shares repurchased	$ 18,269

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Accumulated Other Comprehensive (Loss) Income The component of accumulated other comprehensive (loss) income and the adjustments to other comprehensive (loss) income for amounts reclassified from accumulated other comprehensive (loss) income into net (loss) income is as follows (in thousands):

	Foreign currency translation adjustments	Net unrealized gains (losses) on available-for-sale investments	Accumulated other comprehensive loss
Three months ended July 30, 2016:			
Balance at April 30, 2016	$ (10,143)	$ (117)	$ (10,260)
Other comprehensive (loss) income, net (1)	(2,664)	122	(2,542)
Balance at July 30, 2016	$ (12,807)	$ 5	$ (12,802)
Three months ended August 1, 2015:			
Balance at May 2, 2015	$ (11,673)	$ (94)	$ (11,767)
Other comprehensive loss, net (1)	(2,207)	(28)	(2,235)
Balance at August 1, 2015	$ (13,880)	$ (122)	$ (14,002)

	Foreign currency translation adjustments	Net unrealized gains (losses) on available-for-sale investments	Accumulated other comprehensive income (loss)
Six months ended July 30, 2016:			
Balance at January 30, 2016	$ (15,136)	$ (111)	$ (15,247)
Other comprehensive income, net (1)	2,329	116	2,445
Balance at July 30, 2016	$ (12,807)	$ 5	$ (12,802)
Six months ended August 1, 2015:			
Balance at January 31, 2015	$ (11,205)	$ (73)	$ (11,278)
Other comprehensive loss, net (1)	(2,675)	(49)	(2,724)
Balance at August 1, 2015	$ (13,880)	$ (122)	$ (14,002)

(1) Other comprehensive (loss) income is net of immaterial taxes for the three and six months ended July 30, 2016 and August 1, 2015 for both net unrealized gains (losses) on available-for-sale investments and accumulated other comprehensive loss. Foreign currency translation adjustments are not adjusted for income taxes as they

relate to permanent investments in our international subsidiaries.

7. Equity Awards

We maintain several equity incentive plans under which we may grant incentive stock options, nonqualified stock options, stock bonuses, restricted stock awards, restricted stock units and stock appreciation rights to employees (including officers), non-employee directors and consultants.

We account for stock-based compensation by recording the estimated fair value of stock-based awards granted as compensation expense over the vesting period, net of estimated forfeitures. Stock-based compensation expense is attributed to earnings using a straight-line method. We estimate forfeitures of stock-based awards based on historical experience and expected future activity.

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The fair value of restricted stock awards and units is measured based on the closing price of our common stock on the date of grant. The fair value of stock option grants is estimated on the date of grant using the Black-Scholes option pricing model. The following weighted-average assumptions were used to estimate the fair value of stock options granted:

	Six Months Ended	
	July 30, 2016	August 1, 2015
Dividend yield		
Volatility rate	49.7%	53.4%
Weighted-average expected life (in years)	5.93	6.25
Weighted-average risk-free interest rate	1.6%	1.8%
Weighted-average fair value per share of stock options granted	$ 19.70	$ 20.19

Total stock-based compensation expense is recognized on our condensed consolidated income statements as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Cost of goods sold	$ 241	$ 261	$ 447	$ 503
Selling, general and administrative expenses	945	877	1,774	2,207
Total stock-based compensation expense	$ 1,186	$ 1,138	$ 2,221	$ 2,710

At July 30, 2016, there was $8.2 million of total unrecognized compensation cost related to unvested stock options, restricted stock awards and restricted stock units. This cost has a weighted-average recognition period of 1.3 years.

The following table summarizes restricted stock awards and restricted stock units activity (in thousands, except grant date weighted-average fair value):

	Restricted Stock Awards/Units	Grant Date Weighted-Average Fair Value	Intrinsic Value
Outstanding at January 30, 2016	286	$ 30.32	
Granted	263	$ 18.76	
Vested	(125)	$ 29.67	
Forfeited	(11)	$ 26.46	
Outstanding at July 30, 2016	413	$ 23.25	$ 7,008

The following table summarizes stock option activity (in thousands, except grant date weighted-average exercise price and weighted-average remaining contractual life):

	Stock Options	Grant Date Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in Years)	Intrinsic Value
Outstanding at January 30, 2016	143	$ 27.86		
Granted	82	$ 19.70		
Exercised	(4)	$ 8.64		
Forfeited	(20)	$ 33.53		
Outstanding at July 30, 2016	201	$ 24.40	7.0	$ 123
Exercisable at July 30, 2016	80	$ 25.61	4.9	$ 123

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8. (Loss) Earnings per Share, Basic and Diluted

The following table sets forth the computation of basic and diluted (loss) earnings per share (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net (loss) income	$ (838)	$ 3,213	$ (2,975)	$ 5,983
Weighted average common shares for basic (loss) earnings per share	24,712	28,311	24,957	28,726
Dilutive effect of stock options and restricted stock		128		206
Weighted average common shares for diluted (loss) earnings per share	24,712	28,439	24,957	28,932
Basic (loss) earnings per share	$ (0.03)	$ 0.11	$ (0.12)	$ 0.21
Diluted (loss) earnings per share	$ (0.03)	$ 0.11	$ (0.12)	$ 0.21

Total anti-dilutive common shares related to stock-based awards not included in the calculation of diluted earnings per share were 0.3 million and 0.4 million for the three and six months ended July 30, 2016 and 0.1 million for the three and six months ended August 1, 2015.

9. Subsequent Event

On August 31, 2016, we acquired 100% of the outstanding stock of Fast Times Skateboarding (Fast Times) for $6.9 million paid in $5.5 million of cash and $1.4 million in shares of common stock subject to certain pre-closing and post-closing adjustments. Fast Times is an Australian specialty retailer of skateboards, hardware, apparel and footwear. Fast Times currently operates 5 stores and a website at www.fasttimes.com.au.

Item 2: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this document. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those discussed in Item 1A Risk Factors in our Form 10-K filed with the SEC on March 14, 2016 and in this Form 10-Q.

Forward-looking statements relate to our expectations for future events and future financial performance. Generally, the words anticipates, expects, intends, may, should, plans, believes, predicts, potential, continue and similar expressions identify forward-looking statements. Forward-looking statements involve risks and uncertainties, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements. These statements are only predictions. Actual events or results may differ materially.

Factors which could affect our financial results are described below under the heading Risk Factors and in Item 1A Risk Factors of our Form 10-K referred to in the preceding paragraph. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assume responsibility for the accuracy and completeness of the forward-looking statements. We undertake no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

Fiscal 2016 is the 52-week period ending January 28, 2017. Fiscal 2015 is the 52-week period ending January 30, 2016. The first six months of fiscal 2016 was the 26-week period ended July 30, 2016. The first six months of fiscal 2015 was the 26-week period ended August 1, 2015.

Zumiez, the Company, we, us, its, our and similar references refer to Zumiez Inc. and its wholly-owned subsidiaries.

General

Net sales constitute gross sales (net of actual and estimated returns and deductions for promotions) and shipping revenue. Net sales include our store sales and our ecommerce sales. We record the sale of gift cards as a current liability and recognize revenue when a customer redeems a gift card. Additionally, the portion of gift cards that will not be redeemed (gift card breakage) is recognized in net sales after 24 months, at which time the likelihood of redemption is considered remote based on our historical redemption data.

We report comparable sales based on net sales beginning on the first anniversary of the first day of operation of a new store or ecommerce business. We operate a sales strategy that integrates our stores with our ecommerce platform. There is significant interaction between our store sales and our ecommerce sales channels and we believe that they are utilized in

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tandem to serve our customers. Therefore, our comparable sales also include our ecommerce sales. Changes in our comparable sales between two periods are based on net sales of store or ecommerce businesses which were in operation during both of the two periods being compared and, if a store or ecommerce business is included in the calculation of comparable sales for only a portion of one of the two periods being compared, then that store or ecommerce business is included in the calculation for only the comparable portion of the other period. Any change in square footage of an existing comparable store, including remodels and relocations, does not eliminate that store from inclusion in the calculation of comparable sales. Any store or ecommerce business that we acquire will be included in the calculation of comparable sales after the first anniversary of the acquisition date. Current year foreign exchange rates are applied to both current year and prior year comparable sales to achieve a consistent basis for comparison. There may be variations in the way in which some of our competitors and other apparel retailers calculate comparable sales. As a result, data herein regarding our comparable sales may not be comparable to similar data made available by our competitors or other retailers.

Cost of goods sold consists of branded merchandise costs and our private label merchandise costs including design, sourcing, importing and inbound freight costs. Our cost of goods sold also includes shrinkage, buying, occupancy, distribution and warehousing costs (including associated depreciation) and freight costs for store merchandise transfers. This may not be comparable to the way in which our competitors or other retailers compute their cost of goods sold. Cash consideration received from vendors is reported as a reduction of cost of goods sold if the inventory has sold, a reduction of the carrying value of the inventory if the inventory is still on hand, or a reduction of selling, general and administrative expense if the amounts are reimbursements of specific, incremental and identifiable costs of selling the vendors products.

With respect to the freight component of our ecommerce sales, amounts billed to our customers are included in net sales and the related freight cost is charged to cost of goods sold.

Selling, general and administrative expenses consist primarily of store personnel wages and benefits, administrative staff and infrastructure expenses, freight costs for merchandise shipments from the distribution centers to the stores, store supplies, depreciation on fixed assets at our home office and stores, facility expenses, training expenses and advertising and marketing costs. Credit card fees, insurance, public company expenses, legal expenses, amortization of intangibles, future incentive payments, and other miscellaneous operating costs are also included in selling, general and administrative expenses. This may not be comparable to the way in which our competitors or other retailers compute their selling, general and administrative expenses.

Key Performance Indicators

Our management evaluates the following items, which we consider key performance indicators, in assessing our performance:

Comparable sales. As previously described in detail under the caption General, comparable sales provide a measure of sales growth for stores and ecommerce businesses open at least one year over the comparable prior year period.

We consider comparable sales to be an important indicator of our current performance. Comparable sales results are important to achieve leveraging of our costs, including store payroll and store occupancy. Comparable sales also have a direct impact on our total net sales, operating profit, cash and working capital.

Gross profit. Gross profit measures whether we are optimizing the price and inventory levels of our merchandise. Gross profit is the difference between net sales and cost of goods sold. Any inability to obtain acceptable levels of initial markups or any significant increase in our use of markdowns could have an adverse effect on our gross profit and results of operations.

Operating profit. We view operating profit as a key indicator of our success. Operating profit is the difference between gross profit and selling, general and administrative expenses. The key drivers of operating profit are comparable sales, gross profit, our ability to control selling, general and administrative expenses and our level of capital expenditures affecting depreciation expense.

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Results of Operations

The following table presents selected items on the condensed consolidated statements of income as a percent of net sales:

	Three Months Ended		Six Months Ended	
	July 30, 2016	August 1, 2015	July 30, 2016	August 1, 2015
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	69.2	67.9	70.2	68.0
Gross profit	30.8	32.1	29.8	32.0
Selling, general and administrative expenses	31.5	29.2	31.2	29.3
Operating (loss) profit	(0.7)	2.9	(1.4)	2.7
Interest and other (expense) income, net	(0.1)	(0.1)	0.1	0.1
(Loss) earnings before income taxes	(0.8)	2.8	(1.3)	2.8
(Benefit) provision for income taxes	(0.3)	1.1	(0.5)	1.0
Net (loss) income	(0.5)%	1.7%	(0.8)%	1.8%

Three Months (13 weeks) Ended July 30, 2016 Compared With Three Months (13 weeks) Ended August 1, 2015

Net Sales

Net sales were $178.3 million for the three months ended July 30, 2016 compared to $179.8 million for the three months ended August 1, 2015, a decrease of $1.5 million or 0.9%. The decrease primarily reflected a decrease in comparable sales of $8.7 million, partially offset by the net addition of 33 stores (made up of 32 new stores in North America and 4 new stores in Europe offset by 2 store closures in North America and 1 store closure in Europe) subsequent to August 1, 2015. By region, North America sales decreased $0.4 million or 0.2% and Europe sales decreased $1.2 million or 8.5% for the three months ended July 30, 2016 compared to the three months ended August 1, 2015.

Comparable sales decreased 4.9% primarily driven by a decrease in comparable transactions slightly offset by an increase in dollars per transaction. Dollars per transaction increased due to an increase in units per transaction partially offset by a decrease in average unit retail. Comparable sales decreases in hardgoods, junior s clothing, footwear, and accessories were partially offset by an increase in men s clothing. For information as to how we define comparable sales, see General above.

Gross Profit

Gross profit was $54.8 million for the three months ended July 30, 2016 compared to $57.8 million for the three months ended August 1, 2015, a decrease of $3.0 million, or 5.1%. As a percent of net sales, gross profit decreased 130 basis points for the three months ended July 30, 2016 to 30.8%. The decrease was primarily driven by a 140 basis point decrease due to the deleveraging of our store occupancy costs, partially offset by 30 basis point due to an increase in product margin.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were $56.0 million for the three months ended July 30, 2016 compared to $52.5 million for the three months ended August 1, 2015, an increase of $3.5 million, or 6.7%. SG&A expenses as a percent of net sales increased by 230 basis points for the three months ended July 30, 2016 to 31.5%. The increase was primarily driven by an increase of 160 basis points due to the deleveraging of our store operating expenses and 90 basis points due to the deleveraging of corporate costs.

Net (Loss) Income

Net loss for the three months ended July 30, 2016 was $0.8 million, or $0.03 per diluted share, compared with net income of $3.2 million, or $0.11 per diluted share, for the three months ended August 1, 2015. Our effective income tax rate for the three months ended July 30, 2016 was 38.6% compared to 38.1% for the three months ended August 1, 2015.

Six Months (26 weeks) Ended July 30, 2016 Compared With Six Months (26 weeks) Ended August 1, 2015

Net Sales

Net sales were $351.2 million for the six months ended July 30, 2016 compared to $357.4 million for the six months ended August 1, 2015, a decrease of $6.2 million or 1.7%. The decrease primarily reflected a decrease in comparable sales of $22.0 million, partially offset by the net addition of 33 stores (made up of 32 new stores in North America and 4 new stores in Europe offset by 2 store closures in North America and 1 store closure in Europe) subsequent to August 1, 2015. By region, North America sales decreased $5.2 million or 1.6% and Europe sales decreased $1.0 million or 3.4% for the six months ended July 30, 2016 compared to the six months ended August 1, 2015.

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Comparable sales decreased 6.2% primarily driven by a decrease in comparable transactions slightly offset by an increase in dollars per transaction. Dollars per transaction increased due to an increase in units per transaction partially offset by a decrease in average unit retail. Comparable sales decreases in hardgoods, junior s clothing, footwear, and accessories were partially offset by an increase in men s clothing. For information as to how we define comparable sales, see General above.

Gross Profit

Gross profit was $104.8 million for the six months ended July 30, 2016 compared to $114.3 million for the six months ended August 1, 2015, a decrease of $9.5 million, or 8.3%. As a percent of net sales, gross profit decreased 220 basis points for the six months ended July 30, 2016 to 29.8%. The decrease was primarily driven by a 150 basis point decrease due to the deleveraging of our store occupancy costs and 30 basis points due to higher outbound shipping expenses for customer orders as a percent of net sales.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were $109.9 million for the six months ended July 30, 2016 compared to $104.9 million for the six months ended August 1, 2015, an increase of $5.0 million, or 4.8%. SG&A expenses as a percent of net sales increased by 190 basis points for the six months ended July 30, 2016 to 31.2%. The increase was primarily driven by an increase of 170 basis points due to the deleveraging of our store operating expenses and 50 basis points due to the deleveraging of corporate costs, partially offset by a 30 basis points decrease related to prior year expenses associated with our acquisition of Blue Tomato, including incentive payments made as part of the transaction.

Net (Loss) Income

Net loss for the six months ended July 30, 2016 was $3.0 million, or $0.12 per diluted share, compared with net income of $6.0 million, or $0.21 per diluted share, for the six months ended August 1, 2015. Our effective income tax rate for the six months ended July 30, 2016 was 37.7% compared to 37.9% for the six months ended August 1, 2015.

Liquidity and Capital Resources

Our primary uses of cash are for operational expenditures, inventory purchases and capital investments, including new stores, store remodels, store relocations, store fixtures and ongoing infrastructure improvements. Additionally, we may use cash for the repurchase of our common stock. Historically, our main source of liquidity has been cash flows from operations.

The significant components of our working capital are inventories and liquid assets such as cash, cash equivalents, current marketable securities and receivables, reduced by accounts payable, accrued payroll and accrued expenses. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day or within several days of the related sale, while we typically have longer payment terms with our vendors.

Our capital requirements include construction and fixture costs related to the opening of new stores and remodel and relocation expenditures for existing stores. Future capital requirements will depend on many factors, including the pace of new store openings, the availability of suitable locations for new stores and the nature of arrangements negotiated with landlords. In that regard, our net investment to open a new store has varied significantly in the past due to a number of factors, including the geographic location and size of the new store, and is likely to vary significantly in the future.

During fiscal 2016, we expect to spend approximately $24 million to $26 million on capital expenditures, a majority of which will relate to leasehold improvements and fixtures for the approximately 29 new stores we plan to open in fiscal 2016 and remodels or relocations of existing stores. There can be no assurance that the number of stores that we actually open in fiscal 2016 will not be different from the number of stores we plan to open, or that actual fiscal 2016 capital expenditures will not differ from our expectations.

Operating Activities

Net cash provided by operating activities increased by $5.4 million to $6.4 million for the six months ended July 30, 2016 from $1.0 million for the six months ended August 1, 2015. Our operating cash flows result primarily from cash received from our customers, offset by cash payments we make for inventory, employee compensation, store occupancy expenses and other

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operational expenditures. Cash received from our customers generally corresponds to our net sales. Because our customers primarily use credit cards or cash to buy from us, our receivables from customers settle quickly. Historically, changes to our operating cash flows have been driven primarily by changes in operating income, which is impacted by changes to non-cash items such as depreciation, amortization and accretion, deferred taxes, and excess tax benefit from stock-based compensation, and changes to the components of working capital.

Investing Activities

Net cash used in investing activities was $11.6 million for the six months ended July 30, 2016, related to $11.9 million of capital expenditures primarily for new store openings and existing store remodels or relocations partially offset by $0.3 million in net sales of marketable securities. Net cash provided by investing activities was $53.8 million for the six months ended August 1, 2015, primarily related to $73.9 million in net sales of marketable securities partially offset by $20.0 million of capital expenditures primarily for new store openings and existing store remodels or relocations.

Financing Activities

Net cash used in financing activities for the six months ended July 30, 2016 was $18.7 million, primarily related to $19.1 million cash paid for the repurchase of common stock partially offset by $0.4 million in proceeds from stock-based award exercises. Net cash used in financing activities for the six months ended August 1, 2015 was $53.3 million, primarily related to $59.0 million cash paid for the repurchase of common stock, partially offset by $4.6 million in net proceeds from revolving credit facilities and long-term debt and $1.1 million in proceeds from stock-based award exercises and related tax benefits.

Sources of Liquidity

Our most significant sources of liquidity continue to be funds generated by operating activities and available cash, cash equivalents and current marketable securities. We expect these sources of liquidity and available borrowings under our revolving credit facility will be sufficient to meet our foreseeable cash requirements for operations and planned capital expenditures for at least the next twelve months. Beyond this time frame, if cash flows from operations are not sufficient to meet our capital requirements, then we will be required to obtain additional equity or debt financing in the future. However, there can be no assurance that equity or debt financing will be available to us when we need it or, if available, that the terms will be satisfactory to us and not dilutive to our then-current shareholders.

On February 5, 2016, the Company entered into an asset-based revolving credit agreement with Wells Fargo Bank, National Association, which provides for a senior secured revolving credit facility of up to $100 million (ABL Facility), subject to a borrowing base, with a letter of credit sub-limit of $10 million. The ABL Facility is available for working capital and other general corporate purposes. The ABL Facility replaced our $25.0 million secured revolving credit facility with Wells Fargo, which was entered into on July 9, 2014 and was scheduled to expire on September 1, 2016. The ABL Facility will mature on February 5, 2021.

The ABL Facility is secured by a first-priority security interest in substantially all of the personal property (but not the real property) of the borrowers and guarantors. Amounts borrowed under the ABL Facility bear interest, at the Company s option, at either an adjusted LIBOR rate plus a margin of 1.25% to 1.75% per annum, or an alternate base rate plus a margin of 0.25% to 0.75% per annum. The Company is also required to pay a fee of 0.25% per annum on undrawn commitments under the ABL Facility. Customary agency fees and letter of credit fees are also payable in respect of the ABL Facility.

Additionally, we have revolving lines of credit of up to 7.3 million Euro, the proceeds of which are used to fund certain international operations. The revolving lines of credit bear interest at 1.65%-3.00%. On August 12, 2016, the revolving lines of credit were increased to 20.5 million Euro.

There were no borrowings outstanding under any revolving lines of credit at July 30, 2016 and January 30, 2016. We had $0.3 million in open commercial letters of credit outstanding under these lines of credit at July 30, 2016 and no open commercial letters of credit outstanding at January 30, 2016.

Critical Accounting Estimates

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. In connection with the preparation of our condensed consolidated financial statements, we are required to make assumptions and estimates about future events and apply judgments that affect the reported amounts of assets, liabilities, revenue, expenses and the related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that we believe to be relevant at the time our condensed consolidated financial statements are prepared. On a regular basis, we review the accounting policies, assumptions, estimates and judgments to ensure that our condensed consolidated financial statements are presented fairly and in accordance with U.S. GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

There have been no significant changes to our critical accounting estimates as discussed in our Annual Report on Form 10-K for the fiscal year ended January 30, 2016.

Contractual Obligations and Commercial Commitments

There were no material changes outside the ordinary course of business in our contractual obligations during the six months ended July 30, 2016. The following table summarizes the total amount of future payments due under our contractual obligations at July 30, 2016 (in thousands):

	Total	Fiscal 2016	Fiscal 2017 and Fiscal 2018	Fiscal 2019 and Fiscal 2020	Thereafter
Operating lease obligations (1)	$ 423,359	$ 34,708	$ 126,976	$ 104,337	$ 157,338
Purchase obligations (2)	167,626	167,626			
Total	$ 590,985	$ 202,334	$ 126,976	$ 104,337	$ 157,338

(1) Amounts do not include contingent rent and real estate taxes, insurance, common area maintenance charges and other executory costs obligations. See Note 3, Commitments and Contingencies, in the Notes to Condensed Consolidated Financial Statements found in Item 1 of this Form 10-Q, for additional information related to our operating leases.

(2) We have an option to cancel these commitments with no notice prior to shipment, except for certain private label and international purchase orders in which we are obligated to repay contractual amounts upon cancellation.

Off-Balance Sheet Arrangements

At July 30, 2016, we did not have any off-balance sheet arrangements.

Impact of Inflation/Deflation

We do not believe that inflation has had a material impact on our net sales or operating results for the past three fiscal years. However, substantial increases in costs, including the price of raw materials, labor, energy and other inputs used in the production of our merchandise, could have a significant impact on our business and the industry in the future. Additionally, while deflation could positively impact our merchandise costs, it could have an adverse effect on our average unit retail price, resulting in lower sales and operating results.

Risk Factors

Investing in our securities involves a high degree of risk. The following risk factors, issues and uncertainties should be considered in evaluating our future prospects. In particular, keep these risk factors in mind when you read forward-looking statements elsewhere in this report. Forward-looking statements relate to our expectations for future events and time periods. Generally, the words anticipates, expects, intends, may, should, plans, believes, predicts, potential, continue and similar expressions identify forward-looking statements. Forward-looking statements involve risks and uncertainties, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements. Any of the following risks could harm our business, operating results or financial condition and could result in a complete loss of your investment. Additional risks and uncertainties that are not yet identified or that we currently think are immaterial may also harm our business and financial condition in the future.

Our ability to attract customers to our stores depends heavily on the success of the shopping malls in which many of our stores are located; any decrease in consumer traffic in those malls could cause our sales to be less than expected.

In order to generate customer traffic we depend heavily on locating many of our stores in prominent locations within successful shopping malls. Sales at these stores are derived, in part, from the volume of traffic in those malls. Our stores benefit from the ability of a mall s other tenants to generate consumer traffic in the vicinity of our stores and the continuing popularity of malls

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as shopping destinations. Our sales volume and mall traffic generally may be adversely affected by, among other things, economic downturns in a particular area, competition from ecommerce retailers, non-mall retailers and other malls, increases in gasoline prices, fluctuations in exchange rates in border or tourism-oriented locations and the closing or decline in popularity of other stores in the malls in which we are located. An uncertain economic outlook could curtail new shopping mall development, decrease shopping mall traffic, reduce the number of hours that shopping mall operators keep their shopping malls open or force them to cease operations entirely. A reduction in mall traffic as a result of these or any other factors could have a material adverse effect on our business, results of operations and financial condition.

Our business is dependent upon our being able to anticipate, identify and respond to changing fashion trends, customer preferences and other fashion-related factors; failure to do so could have a material adverse effect on us.

Customer tastes and fashion trends in our market are volatile and tend to change rapidly. Our success depends on our ability to effectively anticipate, identify and respond to changing fashion tastes and consumer preferences, and to translate market trends into appropriate, saleable product offerings in a timely manner. If we are unable to successfully anticipate, identify or respond to changing styles or trends and misjudge the market for our products or any new product lines, our sales may be lower than predicted and we may be faced with a substantial amount of unsold inventory or missed opportunities. In response to such a situation, we may be forced to rely on markdowns or promotional sales to dispose of excess or slow-moving inventory, which could have a material adverse effect on our results of operations.

Our growth strategy depends on our ability to open and operate new stores each year, which could strain our resources and cause the performance of our existing stores to suffer.

Our growth largely depends on our ability to open and operate new stores successfully. However, our ability to open new stores is subject to a variety of risks and uncertainties, and we may be unable to open new stores as planned, and any failure to successfully open and operate new stores could have a material adverse effect on our results of operations. We intend to continue to open new stores in future years while remodeling a portion of our existing store base annually. In addition, our proposed expansion will place increased demands on our operational, managerial and administrative resources. These increased demands could cause us to operate our business less effectively, which in turn could cause deterioration in the financial performance of our individual stores and our overall business. To the extent our new store openings are in markets where we already have stores, we may experience reduced net sales in existing stores in those markets. In addition, successful execution of our growth strategy may require that we obtain additional financing, and we may not be able to obtain that financing on acceptable terms or at all.

In addition, we plan to open new stores in regions of the U.S. or international locations in which we currently have few, or no, stores. The expansion into these markets may present competitive, merchandising, hiring and distribution challenges that are different from those currently encountered in our existing markets. Any of these challenges could adversely affect our business and results of operations.

Failure to successfully integrate any businesses or stores that we acquire could have an adverse impact on our results of operations and financial performance.

We may, from time to time, acquire other retail stores or businesses, such as our acquisition of Blue Tomato, one of the leading European specialty retailers of apparel, footwear, accessories, and hardgoods. We may experience difficulties in integrating any stores or businesses we may acquire, including their facilities, personnel, financial systems, distribution, operations and general operating procedures, and any such acquisitions may also result in the diversion of our capital and our management s attention from other business issues and opportunities. If we experience difficulties in integrating acquisitions or if such acquisitions do not provide the benefits that we expect to receive, we could experience increased costs and other operating inefficiencies, which could have an adverse effect on our results of operations and overall financial performance.

Our plans for international expansion include risks that could have a negative impact on our results of operations.

In fiscal 2011, we opened our first store locations in Canada and we plan to continue to open new stores in Canada. During fiscal 2012, we acquired Blue Tomato, which operates primarily in the European market, and we plan to open new stores in Europe in the future. We may continue to expand internationally, either organically, or through additional acquisitions. International markets may have different competitive conditions, consumer tastes and discretionary spending patterns than our existing U.S. market. As a result, operations in international markets may be less successful than our operations in the U.S. Additionally, consumers in international markets may not be familiar with us or the brands we sell, and we may need to build brand awareness in the markets. Furthermore, we have limited experience with the legal and regulatory environments and market practices outside of the U.S. and cannot guarantee that we will be able to penetrate or successfully operate in international markets. We also expect to incur additional costs in complying with applicable foreign laws and regulations as they pertain to both our products and our operations.

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Additionally, the results of operations of our international subsidiaries are exposed to foreign exchange rate fluctuations. Upon translation, operating results may differ materially from expectations. As we expand our international operations, our exposure to exchange rate fluctuations will increase.

The current uncertainty surrounding the U.S. and global economies, including the European economy, coupled with cyclical economic trends in retailing could have a material adverse effect on our results of operations.

Our retail market historically has been subject to substantial cyclicality. As the U.S. and global economic conditions change, the trends in discretionary consumer spending become unpredictable and discretionary consumer spending could be reduced due to uncertainties about the future. When discretionary consumer spending is reduced, purchases of apparel and related products may decline. The current uncertainty in the U.S. and global economies and increased government debt may have a material adverse impact on our results of operations and financial position.

Because of this cycle, we believe the value message has become more important to consumers. As a retailer that sells approximately 80% branded merchandise, this trend may negatively affect our business, as we generally will have to charge more than vertically integrated private label retailers.

Our sales and inventory levels fluctuate on a seasonal basis, leaving our operating results particularly susceptible to changes in back-to-school and winter holiday shopping patterns. Accordingly, our quarterly results of operations are volatile and may fluctuate significantly.

Our quarterly results of operations have fluctuated significantly in the past and can be expected to continue to fluctuate significantly in the future. Our sales and profitability are typically disproportionately higher in the third and fourth fiscal quarters of each fiscal year due to increased sales during the back-to-school and winter holiday shopping seasons. Sales during these periods cannot be used as an accurate indicator of annual results. As a result of this seasonality, any factors negatively affecting us during the last half of the year, including unfavorable economic conditions, adverse weather or our ability to acquire seasonal merchandise inventory, could have a material adverse effect on our financial condition and results of operations for the entire year. In addition, in order to prepare for the back-to-school and winter holiday shopping seasons, we must order and keep in stock significantly more merchandise than we carry during other times of the year. Any unanticipated decrease in demand for our products during these peak shopping seasons could require us to sell excess inventory at a substantial markdown, which could have a material adverse effect on our business, results of operations and financial condition.

Our quarterly results of operations are affected by a variety of other factors, including:

- the timing of new store openings and the relative proportion of our new stores to mature stores;
- whether we are able to successfully integrate any new stores that we acquire and the presence of any unanticipated liabilities in connection therewith;
- fashion trends and changes in consumer preferences;
- calendar shifts of holiday or seasonal periods;

changes in our merchandise mix;

timing of promotional events;

general economic conditions and, in particular, the retail sales environment;

actions by competitors or mall anchor tenants;

weather conditions;

the level of pre-opening expenses associated with our new stores; and