

Zumiez Inc  
Form 10-Q  
May 29, 2013  
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**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 MAY 4, 2013**

**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)**

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**Washington**  
(State or other jurisdiction of  
incorporation or organization)  
**4001 204<sup>th</sup> Street SW, Lynnwood, WA 98036**  
(Address of principal executive offices) (Zip Code)

**91-1040022**  
(I.R.S. Employer  
Identification No.)

**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  No

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

Indicate by check mark 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  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  No

At May 22, 2013, there were 30,175,052 shares outstanding of common stock.

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**ZUMIEZ INC.**

**FORM 10-Q**

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**Table of Contents****ZUMIEZ INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)**

	<b>May 4, 2013 (Unaudited)</b>	<b>February 2, 2013</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 14,661	\$ 17,579
Marketable securities	82,986	85,593
Receivables	10,466	9,467
Inventories	90,870	77,598
Prepaid expenses and other	9,456	9,192
Deferred tax assets	4,104	3,885
<b>Total current assets</b>	<b>212,543</b>	<b>203,314</b>
Fixed assets, net	117,826	115,474
Goodwill	62,539	64,576
Intangible assets, net	19,097	20,480
Long-term other assets	4,979	5,254
<b>Total long-term assets</b>	<b>204,441</b>	<b>205,784</b>
<b>Total assets</b>	<b>\$ 416,984</b>	<b>\$ 409,098</b>
<b>Liabilities and Shareholders Equity</b>		
<b>Current liabilities</b>		
Trade accounts payable	\$ 36,210	\$ 16,052
Accrued payroll and payroll taxes	6,745	11,057
Income taxes payable	971	6,957
Deferred rent and tenant allowances	5,252	4,901
Other liabilities	16,307	18,232
<b>Total current liabilities</b>	<b>65,485</b>	<b>57,199</b>
Long-term deferred rent and tenant allowances	38,863	36,928
Long-term deferred tax liabilities	5,074	5,544
Long-term debt and other liabilities	6,321	6,006
<b>Total long-term liabilities</b>	<b>50,258</b>	<b>48,478</b>
<b>Total liabilities</b>	<b>115,743</b>	<b>105,677</b>
Commitments and contingencies (Note 5)		
<b>Shareholders equity</b>		
Preferred stock, no par value, 20,000 shares authorized; none issued and outstanding		
Common stock, no par value, 50,000 shares authorized; 30,163 shares issued and outstanding at May 4, 2013 and 30,114 shares issued and outstanding at February 2, 2013		
	110,784	108,360
Accumulated other comprehensive income	2,588	6,010
Retained earnings	187,869	189,051
<b>Total shareholders equity</b>	<b>301,241</b>	<b>303,421</b>

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<b>Total liabilities and shareholders equity</b>	\$ 416,984	\$ 409,098
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See accompanying notes to condensed consolidated financial statements

**Table of Contents****ZUMIEZ INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except per share amounts)****(Unaudited)**

	<b>Three Months Ended</b>	
	<b>May 4, 2013</b>	<b>April 28, 2012</b>
Net sales	\$ 148,496	\$ 129,899
Cost of goods sold	100,524	87,798
<b>Gross profit</b>	<b>47,972</b>	<b>42,101</b>
Selling, general and administrative expenses	43,943	34,839
<b>Operating profit</b>	<b>4,029</b>	<b>7,262</b>
Interest income, net	215	490
Other (expense) income, net	(146)	17
<b>Earnings before income taxes</b>	<b>4,098</b>	<b>7,769</b>
Provision for income taxes	1,600	3,242
<b>Net income</b>	<b>\$ 2,498</b>	<b>\$ 4,527</b>
Basic earnings per share	\$ 0.08	\$ 0.15
Diluted earnings per share	\$ 0.08	\$ 0.14
<b>Weighted average shares used in computation of earnings per share:</b>		
Basic	29,714	30,779
Diluted	30,183	31,401

See accompanying notes to condensed consolidated financial statements

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**ZUMIEZ INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(In thousands)**

**(Unaudited)**

	<b>Three Months Ended</b>	
	<b>May 4, 2013</b>	<b>April 28, 2012</b>
Net income	\$ 2,498	\$ 4,527
Other comprehensive (loss) income, net of tax and reclassification adjustments:		
Foreign currency translation	(3,405)	96
Net change in unrealized gain/loss on available-for-sale investments	(17)	(40)
Other comprehensive (loss) income, net	(3,422)	56
<b>Comprehensive (loss) income</b>	<b>\$ (924)</b>	<b>\$ 4,583</b>

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		Accumulated Other Comprehensive Income	Retained Earnings	Total
	Shares	Amount			
<b>Balance at February 2, 2013</b>	30,114	\$ 108,360	\$ 6,010	\$ 189,051	\$ 303,421
Net income				2,498	2,498
Other comprehensive loss, net			(3,422)		(3,422)
Issuance and exercise of stock-based compensation, including tax benefit of \$529	214	911			911
Stock-based compensation expense		1,513			1,513
Repurchase of common stock	(165)			(3,680)	(3,680)
<b>Balance at May 4, 2013</b>	30,163	\$ 110,784	\$ 2,588	\$ 187,869	\$ 301,241

	Common Stock		Accumulated Other Comprehensive Income	Retained Earnings	Total
	Shares	Amount			
<b>Balance at January 28, 2012</b>	31,170	\$ 99,412	\$ 135	\$ 172,730	\$ 272,277
Net income				4,527	4,527
Other comprehensive income, net			56		56
Issuance and exercise of stock-based compensation, including tax benefit of \$1,710	154	1,953			1,953
Stock-based compensation expense		1,606			1,606
<b>Balance at April 28, 2012</b>	31,324	\$ 102,971	\$ 191	\$ 177,257	\$ 280,419

See accompanying notes to condensed consolidated financial statements



**Table of Contents****ZUMIEZ INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	<b>Three Months Ended</b>	
	<b>May 4, 2013</b>	<b>April 28, 2012</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,498	\$ 4,527
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	6,331	5,275
Deferred taxes	(260)	(35)
Stock-based compensation expense	1,513	1,606
Excess tax benefit from stock-based compensation	(529)	(1,710)
Other	114	(74)
Changes in operating assets and liabilities:		
Receivables	(1,068)	(2,172)
Inventories	(13,685)	(5,355)
Prepaid expenses and other	(440)	(411)
Trade accounts payable	19,848	14,297
Accrued payroll and payroll taxes	(4,272)	(1,978)
Income taxes payable	(5,415)	(7,443)
Deferred rent and tenant allowances	2,324	1,821
Other liabilities	(2,557)	(2,549)
Net cash provided by operating activities	4,402	5,799
<b>Cash flows from investing activities:</b>		
Additions to fixed assets	(6,374)	(8,519)
Purchases of marketable securities and other investments	(15,137)	(43,375)
Sales and maturities of marketable securities and other investments	17,315	37,317
Net cash used in investing activities	(4,196)	(14,577)
<b>Cash flows from financing activities:</b>		
Payments on long-term debt	(77)	
Repurchase of common stock	(3,680)	
Proceeds from exercise of stock-based compensation, net of withholding tax payments	382	243
Excess tax benefit from stock-based compensation	529	1,710
Net cash (used in) provided by financing activities	(2,846)	1,953
Effect of exchange rate changes on cash and cash equivalents	(278)	8
Net decrease in cash and cash equivalents	(2,918)	(6,817)
Cash and cash equivalents, beginning of period	17,579	14,779
Cash and cash equivalents, end of period	\$ 14,661	\$ 7,962
<b>Supplemental disclosure on cash flow information:</b>		
Cash paid during the period for income taxes	\$ 7,266	\$ 10,705

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Accrual for purchases of fixed assets	3,534	5,840
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. (the Company, we, us, its and our ) is a leading multi-channel specialty retailer of action sports related apparel, footwear, accessories and hardgoods, focusing on skateboarding, snowboarding, surfing, motocross and bicycle motocross ( BMX ) for young men and women. At May 4, 2013, we operated 503 stores; 475 in the United States ( U.S. ), 22 in Canada and 6 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. Fiscal 2013 is the 52-week period ending February 1, 2014. Fiscal 2012 was the 53-week period ending February 2, 2013. The first three months of fiscal 2013 was the 13-week period ended May 4, 2013. The first three months of fiscal 2012 was the 13-week period ended April 28, 2012.

**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 February 2, 2013 is derived from audited consolidated financial statements, which are included in our Annual Report on Form 10-K for the year ended February 2, 2013, 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 seasonal 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.

**Recently Adopted Accounting Standards** In February 2013, the Financial Accounting Standards Board ( FASB ) issued guidance that requires an entity to present information about reclassification adjustments from accumulated other comprehensive income in their financial statements or footnotes. This guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2012. We adopted this guidance for the fiscal quarter ended May 4, 2013 and the adoption did not have a material impact on our condensed consolidated financial statements.

**Recently Issued Accounting Standards** In July 2012, the FASB issued guidance that will allow an entity to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test for indefinite-lived intangible assets. If entities determine, based on qualitative factors, the fair value of the asset is more likely than not less than the carrying value, the two-step impairment test would be required. This guidance is effective for fiscal years beginning after September 15, 2012, with early adoption permitted. We will adopt this guidance for the fiscal year ending February 1, 2014 and we do not expect the adoption will have a material impact on our condensed consolidated financial statements.



**Table of Contents****2. Business Combination**

**Blue Tomato** On July 4, 2012, we acquired 100% of the outstanding stock of Blue Tomato for cash consideration of 59.5 million Euros (\$74.8 million). Blue Tomato is a leading European multi-channel retailer for board sports and related apparel and footwear and the acquisition allows us to enter into the European marketplace.

In addition, there is the possibility of future incentive payments to the sellers and certain employees of Blue Tomato in an aggregate amount of up to 22.1 million Euros (\$28.9 million, using the exchange rate as of May 4, 2013) to the extent that certain financial metrics are met for the fiscal year ended April 30, 2015 and the sellers and certain employees remain employed with Blue Tomato through April 30, 2015. Of the 22.1 million Euros future incentive payments, 17.1 million Euros (\$22.4 million) is payable in cash, while 5.0 million Euros (\$6.5 million) is payable in shares of our common stock. We account for the estimated future incentive payments as compensation expense and recognize this amount ratably over the term of service through April 2015. At May 4, 2013, we estimated we will be obligated for future incentive payments of 9.0 million Euros (\$11.8 million) and for the three months ended May 4, 2013, we recorded \$1.1 million of this amount, which is included in selling, general and administrative expense on the condensed consolidated statements of income.

Transaction costs, such as investment advisory, legal and accounting fees, associated with the Blue Tomato acquisition were \$0.4 million for the three months ended April 28, 2012. There were no transaction costs recorded for the three months ended May 4, 2013. These expenses are recorded in selling, general and administrative expense on the condensed consolidated statements of income.

**Pro Forma Financial Information** The following pro forma financial information shows the results of operations for the three months ended April 28, 2012 (in thousands), as though the acquisition of Blue Tomato had occurred on January 30, 2011. These amounts were calculated after conversion to U.S. GAAP, conforming to our accounting policies and adjusting Blue Tomato results to reflect: (i) the depreciation and amortization that would have been charged assuming the preliminary fair value adjustments to property, plant and equipment and intangible assets and (ii) the compensation expense associated with the estimated future incentive payments to the sellers and certain employees of Blue Tomato (using our initial estimate of future incentive payments of 18.1 million Euros). The adjustments also reflect the income tax effect of the pro forma adjustments.

The amounts also reflect the removal of non-recurring, transaction related costs and related income tax effect from fiscal 2012 pro forma results of \$0.4 million associated with the Blue Tomato acquisition.

The pro forma financial information below is presented for illustrative purposes only and is not necessarily indicative of the operating results that would have been achieved had the acquisition been completed as of the date indicated above or the results that may be obtained in the future.

	Three Months Ended April 28, 2012
Net sales	\$ 138,313
Net income	\$ 2,219

**3. Intangible Assets**

The following table summarizes the gross carrying amount, accumulated amortization and the net carrying amount of intangible assets at May 4, 2013 and February 2, 2013 (in thousands):

	May 4, 2013			Weighted- Average Useful Life
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	
Trade names and trademarks	\$ 14,140	\$	\$ 14,140	Indefinite-lived
Developed technology	3,928	1,091	2,837	3 years
Customer relationships	2,911	791	2,120	3 years

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Total intangible assets	\$ 20,979	\$ 1,882	\$ 19,097
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	February 2, 2013			Weighted-Average Useful Life
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	
Trade names and trademarks	\$ 14,724	\$	\$ 14,724	Indefinite-lived
Developed technology	4,090	795	3,295	3 years
Customer relationships	3,031	570	2,461	3 years
Total intangible assets	\$ 21,845	\$ 1,365	\$ 20,480	

There was no impairment of intangible assets for the three months ended May 4, 2013. Amortization expense of acquisition-related intangible assets for the three months ended May 4, 2013 was \$0.6 million. We did not record amortization expense of acquisition-related intangible assets for the three months ended April 28, 2012. Amortization expense of acquisition-related intangible assets is recorded in selling, general and administrative expense on the condensed consolidated statements of income.

**4. 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 at May 4, 2013 and February 2, 2013 (in thousands):

	May 4, 2013			Estimated Fair Value
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	
<b>Cash and cash equivalents:</b>				
Cash	\$ 6,228	\$	\$	\$ 6,228
Money market funds	5,226			5,226
State and local government securities	3,207			3,207
<b>Total cash and cash equivalents</b>	<b>14,661</b>			<b>14,661</b>
<b>Marketable securities:</b>				
Corporate debt securities	1,234	50		1,284
State and local government securities	74,356	69	(173)	74,252
Variable-rate demand notes	8,300			8,300
<b>Total marketable securities</b>	<b>\$ 83,890</b>	<b>\$ 119</b>	<b>\$ (173)</b>	<b>\$ 83,836</b>
<b>Less: Long-term marketable securities (1)</b>				<b>(850)</b>
<b>Total current marketable securities</b>				<b>\$ 82,986</b>

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		February 2, 2013		Estimated
	Amortized	Gross	Gross	Fair
	Cost	Unrealized	Unrealized	Value
		Holding	Holding	
		Gains	Losses	
<b>Cash and cash equivalents:</b>				
Cash	\$ 6,271	\$	\$	\$ 6,271
Money market funds	8,305			8,305
State and local government securities	3,003			3,003
<b>Total cash and cash equivalents</b>	<b>17,579</b>			<b>17,579</b>
<b>Marketable securities:</b>				
Corporate debt securities	1,745	65		1,810
State and local government securities	82,911	95	(179)	82,827
Variable-rate demand notes	1,800			1,800
<b>Total marketable securities</b>	<b>\$ 86,456</b>	<b>\$ 160</b>	<b>\$ (179)</b>	<b>\$ 86,437</b>
<b>Less: Long-term marketable securities (1)</b>				<b>(844)</b>
<b>Total current marketable securities</b>				<b>\$ 85,593</b>

(1) At May 4, 2013 and February 2, 2013, we held one auction rate security, classified as available-for-sale marketable securities and included in long-term other assets on the condensed consolidated balance sheets.

All of our available-for-sale securities, excluding our auction rate security, have an effective maturity of two years or less and may be liquidated, at our discretion, prior to maturity. For the three months ended May 4, 2013 and April 28, 2012, realized gains and losses on sales of available-for-sale marketable securities were not material.

The following tables summarize the gross unrealized holding losses and fair value for investments in an unrealized loss position at May 4, 2013 and February 2, 2013, and the length of time that individual securities have been in a continuous loss position (in thousands):

	Less Than 12 Months		May 4, 2013		Total	
	Fair Value	Unrealized	Fair Value	Unrealized	Fair Value	Unrealized
		Losses		Losses		Losses
<b>Marketable securities:</b>						
State and local government securities	18,973	(21)	3,223	(152)	22,196	(173)
<b>Total marketable securities</b>	<b>\$ 18,973</b>	<b>\$ (21)</b>	<b>\$ 3,223</b>	<b>\$ (152)</b>	<b>\$ 22,196</b>	<b>\$ (173)</b>

	Less Than 12 Months		February 2, 2013		Total	
	Fair Value	Unrealized	Fair Value	Unrealized	Fair Value	Unrealized
		Losses		Losses		Losses
<b>Marketable securities:</b>						
State and local government securities	23,300	(23)	844	(156)	24,144	(179)
<b>Total marketable securities</b>	<b>\$ 23,300</b>	<b>\$ (23)</b>	<b>\$ 844</b>	<b>\$ (156)</b>	<b>\$ 24,144</b>	<b>\$ (179)</b>



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We did not record a realized loss for other-than-temporary impairments during the three months ended May 4, 2013 and April 28, 2012. At May 4, 2013 and February 2, 2013, we had recorded a temporary impairment charge of \$0.2 million related to our \$1.0 million par value auction rate security. We do not intend to sell this security and it is more likely than not that we will be able to hold the investment until the market improves.

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**Leases** We lease our stores and certain corporate and other operating facilities under operating leases. Total rent expense, base rent expense and contingent and other rent expense for the three months ended May 4, 2013 and April 28, 2012 is as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>May 4, 2013</b>	<b>April 28, 2012</b>
Base rent expense	\$ 12,909	\$ 11,061
Contingent and other rent expense (1)	7,913	7,056
<b>Total rent expense</b>	<b>\$ 20,822</b>	<b>\$ 18,117</b>

(1) Included in other rent expense are payments of real estate taxes, insurance and common area maintenance costs. 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. Amounts in the table below do not include contingent rent, real estate taxes, insurance or common area maintenance costs unless these costs are fixed and determinable. Future minimum commitments on all leases at May 4, 2013 are as follows (in thousands):

Fiscal 2013	\$ 51,550
Fiscal 2014	69,674
Fiscal 2015	67,621
Fiscal 2016	64,744
Fiscal 2017	58,352
Thereafter	187,971
<b>Total</b>	<b>\$ 499,912</b>

**Purchase Commitments** At May 4, 2013, we had outstanding purchase orders to acquire merchandise from vendors of \$155.4 million. We have an option to cancel these commitments with no notice prior to shipment, except for certain private label 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 the Company's shareholders.

On February 15, 2013, a putative class action lawsuit, Robert Steele v. Zumiez Inc., was filed against the Company in the Superior Court of the State of California, County of San Francisco. The lawsuit purports to be brought on behalf of a class of all persons who are employed, or who have worked as, assistant store managers for the Company in the State of California from February 15, 2009 through the date of certification of the class in the lawsuit. The lawsuit alleges causes of action for failure to pay overtime wages, failure to pay wages for work done off-the-clock, failure to provide meal periods and rest breaks (and to pay meal and rest period premiums), failure to pay terminated employees all wages due at the time of termination, failure to provide employees with accurate itemized wage statements, failure to reimburse employees for business expenses and unfair business practices and declaratory relief. The Company is investigating Plaintiff's claims. The Court has not set a date for a hearing on class certification and has not set a trial date. At this stage of the litigation, the Company is not in a position to predict the likelihood of an unfavorable outcome or the range of potential loss.

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**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 insurance reserve at May 4, 2013 and February 2, 2013 was \$1.4 million and \$1.2 million.

### 6. Fair Value Measurements

**6. 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 at May 4, 2013 and February 2, 2013 (in thousands):

	May 4, 2013		
	Level 1	Level 2	Level 3
Cash equivalents:			
Money market funds	\$ 5,226	\$	\$
State and local government securities		3,207	
Marketable securities:			
Corporate debt securities		1,284	
State and local government securities		73,402	
Variable-rate demand notes		8,300	
Long-term other assets:			
State and local government securities			850
Equity investments			918
<b>Total</b>	<b>\$ 5,226</b>	<b>\$ 86,193</b>	<b>\$ 1,768</b>

	February 2, 2013		
	Level 1	Level 2	Level 3
Cash equivalents:			
Money market funds	\$ 8,305	\$	\$
State and local government securities		3,003	
Marketable securities:			
Corporate debt securities		1,810	
State and local government securities		81,983	
Variable-rate demand notes		1,800	
Long-term other assets:			
State and local government securities			844
Equity investments			1,059
<b>Total</b>	<b>\$ 8,305</b>	<b>\$ 88,596</b>	<b>\$ 1,903</b>

Our policy is to recognize transfers into and transfers out of hierarchy levels as of the actual date of the event or change in circumstances that caused the transfer.

The Level 2 marketable securities primarily include state and local municipal securities, corporate debt 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.

The Level 3 state and local government securities represent one auction rate security. Our valuation method for the auction rate security is based on numerous assumptions including assessments of the underlying security, expected cash flows, credit ratings, liquidity and other relevant factors.

The Level 3 equity investments primarily represent our 14.3% interest in a manufacturer of apparel and hard goods. The equity investment is valued using comparative market multiples adjusted by an estimated discount factor. We have elected to apply fair value accounting for this investment, which would otherwise be accounted for under the equity method of accounting. We have elected fair value accounting, as we believe the terms of the contract are more properly reflected through the fair value method.



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There were no material assets measured at fair value on a nonrecurring basis for the three months ended May 4, 2013 and April 28, 2012.

**7. Stockholders Equity**

**Share Repurchase** In November 2012, our Board of Directors authorized a share repurchase program that provided for the repurchase of up to \$22.0 million of outstanding common stock. This program was completed in December 2012. In December 2012, our Board of Directors authorized a stock repurchase program that provides for the repurchase of up to an additional \$20.0 million of outstanding common stock. The repurchase program is expected to continue through the fiscal year ending February 1, 2014, unless the time period is extended or shortened by the Board of Directors.

The following table summarizes common stock repurchase activity during the three months ended May 4, 2013 (in thousands except average price per repurchased shares):

Number of shares repurchased	165
Average price per share of repurchased shares (with commission)	\$ 22.36
Total cost of shares repurchased	\$ 3,680

At May 4, 2013, there remains \$12.5 million available to repurchase shares under this program.

**Comprehensive Income** Other comprehensive income by component and the related tax effects for the three months ended May 4, 2013 and April 28, 2012 is as follows (in thousands):

	Before-Tax Amount	Tax Expense or Benefit	Net-of-Tax Amount
<b>Three months ended May 4, 2013:</b>			
Foreign currency translation adjustments (1)	\$ (3,405)	\$	\$ (3,405)
Unrealized losses on available-for-sale investments:			
Unrealized holding gains/(losses) arising during period	(13)	5	(8)
Reclassification adjustment for (gains)/losses realized in net income	(15)	6	(9)
Net unrealized losses on available-for-sale investments	(28)	11	(17)
Other comprehensive loss	\$ (3,433)	\$ 11	\$ (3,422)
<b>Three months ended April 28, 2012:</b>			
Foreign currency translation adjustments (1)	\$ 96	\$	\$ 96
Unrealized gains on available-for-sale investments:			
Unrealized holding gains/(losses) arising during period	(65)	25	(40)
Net unrealized gains on available-for-sale investments	(65)	25	(40)
Other comprehensive income	\$ 31	\$ 25	\$ 56

(1) Foreign currency translation adjustments are not adjusted for income taxes as they relate to permanent investments in our international subsidiaries.



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**Accumulated Other Comprehensive Income** The changes in the balances of each component of accumulated other comprehensive income, net of tax, for the three months ended May 4, 2013 and April 28, 2012 are as follows (in thousands):

	Foreign currency translation adjustments	Net unrealized gains (losses) on available-for- sale investments	Accumulated other comprehensive income
<b>Three months ended May 4, 2013:</b>			
Balance at February 2, 2013	\$ 6,021	\$ (11)	\$ 6,010
Other comprehensive income before reclassifications	(3,405)	(8)	(3,413)
Reclassifications recorded in:			
Other (expense) income, net		(15)	(15)
Provision for income taxes		6	6
Total reclassifications from accumulated other comprehensive income, net of taxes			
		(9)	(9)
Balance at May 4, 2013	\$ 2,616	\$ (28)	\$ 2,588
<b>Three months ended April 28, 2012:</b>			
Balance at January 28, 2012	\$ (19)	\$ 154	\$ 135
Other comprehensive income	96	(40)	56
Balance at April 28, 2012	\$ 77	\$ 114	\$ 191

**8. Equity Awards**

**8. 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 is recognized as compensation expense over the vesting period, net of estimated forfeitures. Stock-based compensation expense is recognized using an accelerated method for stock options and a straight-line basis for restricted stock. We estimate forfeitures of stock-based awards based on historical experience and expected future activity.

The fair value of restricted stock grants is measured based on the closing fair market value 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 method with the following weighted-average assumptions used for stock options granted during the three months ended May 4, 2013 and April 28, 2012:

	Three Months Ended	
	May 4, 2013	April 28, 2012
Dividend yield	%	%
Volatility rate	66.36%	66.71%
Weighted-average expected life (in years)	6.25	6.25
Weighted-average risk-free interest rate	1.12%	1.24%
Weighted-average fair value per share of stock options granted	\$ 15.07	\$ 21.13

The following table summarizes our restricted stock activity for the three months ended May 4, 2013 (in thousands except grant date weighted-average fair value):



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	<b>Restricted Stock</b>	<b>Grant Date Weighted- Average Fair Value</b>	<b>Intrinsic Value (1)</b>
Outstanding at February 2, 2013	382	\$ 23.97	
Granted year to date	177	\$ 24.80	
Vested year to date	(171)	\$ 18.15	
Forfeited year to date	(3)	\$ 29.92	
Outstanding at May 4, 2013	385	\$ 26.90	\$ 11,560

(1) Intrinsic value for restricted stock is defined as the market value of the outstanding restricted stock on the last business day of the quarter.

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The following table summarizes our stock option activity for the three months ended May 4, 2013 (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 (1)
Outstanding at February 2, 2013	820	\$ 17.62		
Granted year to date	47	\$ 24.81		
Exercised year to date	(29)	\$ 7.27		
Outstanding at May 4, 2013	838	\$ 18.37	4.77	\$ 10,702
Exercisable at May 4, 2013	659	\$ 17.78	4.16	\$ 8,929

(1) Intrinsic value for stock options is defined as the difference between the market price of the Company's common stock on the last business day of the quarter and the weighted average exercise price of in-the-money options outstanding at the end of each fiscal period.

We recorded \$1.5 million and \$1.6 million of total stock-based compensation expense for the three months ended May 4, 2013 and April 28, 2012.

At May 4, 2013, there was \$12.5 million of total unrecognized compensation cost related to unvested stock options and restricted stock grants and the remaining estimated future incentive payments payable in shares of our common stock associated with the Blue Tomato acquisition. This cost has a weighted-average recognition period of 1.3 years.

## 9. Earnings per Share, Basic and Diluted

**9. Earnings per Share, Basic and Diluted** The following table sets forth the computation of basic and diluted earnings per share for the three months ended May 4, 2013 and April 28, 2012 (in thousands, except per share amounts):

	Three Months Ended	
	May 4, 2013	April 28, 2012
Net income	\$ 2,498	\$ 4,527
Weighted average common shares for basic earnings per share	29,714	30,779
Dilutive effect of stock options and restricted stock	469	622
Weighted average common shares for diluted earnings per share	30,183	31,401
Basic earnings per share	\$ 0.08	\$ 0.15
Diluted earnings per share	\$ 0.08	\$ 0.14

Total anti-dilutive common stock options not included in the calculation of diluted earnings per share were approximately 0.4 million and 0.2 million for the three months ended May 4, 2013 and April 28, 2012.

## 10. Exit and Disposal

**10. Exit and Disposal Activities** During the fiscal year ended February 2, 2013, we entered into a 10 year lease agreement to lease up to 153,095 square feet in Edwardsville, Kansas and relocated our ecommerce fulfillment center to this facility. We believe that the Edwardsville, Kansas fulfillment center will provide the additional capacity needed to support the continued growth of our ecommerce business, while also increasing the speed at which we get product to our customers and lowering the freight and distribution costs once the Edwardsville, Kansas fulfillment center is running effectively and at full capacity. Additionally, during the fiscal year ended February 2, 2013, we relocated our home office to Lynnwood, Washington.

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We do not expect to incur further material costs related to the relocations. The following table is a summary of the exit and disposal activity and liability balances as a result of the ecommerce fulfillment center and home office relocations (in thousands):

	<b>Employee benefit costs</b>	<b>Lease termination costs (1)</b>	<b>Other exit costs</b>	<b>Total</b>
January 28, 2012	\$	\$ 241	\$	\$ 241
Additions	245	920	440	1,605
Payments	(245)	(864)	(440)	(1,549)
Adjustments (2)		874		874
February 2, 2013 (3)		1,171		1,171
Payments		(150)		(150)
May 4, 2013 (3)	\$	\$ 1,021	\$	\$ 1,021

- (1) Included in lease termination costs are the previously recorded lease termination costs associated with our distribution center relocation in fiscal 2010, as all costs are associated with the same lease. The liability for lease termination costs is based on the present value of future rent obligations and other related costs, net of estimated sublease rent, for the Everett, Washington exited facility, where we are under lease until June 2017. We will monitor the estimated liability for lease termination costs in subsequent periods and revise the liability, if necessary.
- (2) The adjustment to the lease termination costs liability during the fiscal year ended February 2, 2013 represents the outstanding deferred rent liability of \$0.4 million associated with the Everett, Washington exited facility and a \$0.5 million adjustment as a result of our revised estimate for lease termination costs.
- (3) The exit or disposal provisions related to the ecommerce fulfillment center and home office relocations at May 4, 2013 and February 2, 2013 are included in other liabilities and long-term debt and other liabilities on the condensed consolidated balance sheets.

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**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 19, 2013 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.*

*References in the following discussion to we, us, our, the Company and similar references mean Zumiez Inc. and its wholly-owned subsidiaries, unless otherwise expressly stated or the context otherwise requires.*

**General**

Net sales constitute gross sales net of actual and estimated returns, deductions for promotions and shipping revenue. Net sales include our in-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 store 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 in-store sales and our ecommerce sales channels and we believe that they are utilized in tandem to serve our customers. Therefore, our comparable store sales also include our ecommerce sales. Changes in our comparable store sales between two periods are based on net sales of in-store or ecommerce businesses which were in operation during both of the two periods being compared and, if a in-store or ecommerce business is included in the calculation of comparable store sales for only a portion of one of the two periods being compared, then that in-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 store sales. Any store or ecommerce business that we acquire will be included in the calculation of comparable store sales after the first anniversary of the acquisition date. As such, Blue Tomato results will not be included in the calculation of comparable store sales until July 2013. Current year foreign exchange rates are applied to both current year and prior year comparable store 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 or same store sales. As a result, data herein regarding our comparable store 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, ecommerce fulfillment, 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.



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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 and training, advertising and marketing costs. Credit card fees, insurance, public company expenses, legal expenses, amortization of intangibles 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 store sales.* As previously described in detail under the caption "General," comparable store 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 store sales to be an important indicator of our current performance. Comparable store sales results are important to achieve leveraging of our costs, including store payroll, store supplies and rent. Comparable store sales also have a direct impact on our total net sales, 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. The key drivers of operating profit are comparable store sales, gross profit, our ability to control selling, general and administrative expenses and our level of capital expenditures affecting depreciation expense.

### **Critical Accounting Estimates**

Our condensed consolidated financial statements have been prepared in conformance with U.S. GAAP. In connection with the preparation of the condensed consolidated financial statements, we are required to make assumptions and estimates about future events and apply judgments that affect the reported amount 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 the condensed consolidated financial statements are prepared. On a regular basis, we review the accounting policies, assumptions, estimates and judgments to ensure that the 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 February 2, 2013.

### **Results of Operations**

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

	<b>Three Months Ended</b>	
	<b>May 4, 2013</b>	<b>April 28, 2012</b>
Net sales	100.0%	100.0%
Cost of goods sold	67.7	67.6
Gross profit	32.3	32.4
Selling, general and administrative expenses	29.6	26.8
Operating profit	2.7	5.6

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Interest and other income, net	0.1	0.4
Earnings before income taxes	2.8	6.0
Provision for income taxes	1.1	2.5
Net income	1.7%	3.5%



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### **Three Months (13 weeks) Ended May 4, 2013 Compared With Three Months (13 weeks) Ended April 28, 2012**

#### ***Net Sales***

Net sales were \$148.5 million for the three months ended May 4, 2013 compared to \$129.9 million for the three months ended April 28, 2012, an increase of \$18.6 million or 14.3%. The increase reflected the net addition of 42 U.S. and Canada stores (48 new stores offset by six store closures) subsequent to April 28, 2012 and the acquisition of Blue Tomato during the second quarter of fiscal 2012, partially offset by a comparable store sales decrease of 0.7% for the three months ended May 4, 2013.

The 0.7% decrease in comparable stores sales was a result of a 1.8% decrease for our comparable in-store sales, partially offset by a 13.1% increase for our comparable ecommerce sales. Total ecommerce sales represented 11.8% of sales for the three months ended May 4, 2013, compared to 7.7% of sales for the three months ended April 28, 2012, and this increase was driven by the growth in comparable ecommerce sales mentioned above and our Blue Tomato acquisition. The decrease in comparable store sales was primarily driven by a decline in comparable store transactions, partially offset by an increase in dollars per transaction. Dollars per transaction increased due to an increase in units per transaction and an increase in average unit retail. Comparable store sales decreases in men's clothing, accessories, footwear and boys clothing were partially offset by comparable store sales increases in junior's clothing and hardgoods. For information as to how we define comparable stores, see [General](#) above.

#### ***Gross Profit***

Gross profit was \$48.0 million for the three months ended May 4, 2013 compared to \$42.1 million for the three months ended April 28, 2012, an increase of \$5.9 million, or 13.9%. As a percent of net sales, gross profit decreased 10 basis points for the three months ended May 4, 2013 to 32.3%. The decrease was primarily due to deleveraging our fixed costs on a negative 0.7% comparable store sales and an increase in ecommerce related costs due to ecommerce sales increasing as a percentage of total sales. This increase was partially offset by a 60 basis points impact from product margin improvements.

#### ***Selling, General and Administrative Expenses***

Selling, general and administrative (SG&A) expenses were \$43.9 million for the three months ended May 4, 2013 compared to \$34.8 million for the three months ended April 28, 2012, an increase of \$9.1 million, or 26.1%. SG&A expenses as a percent of net sales increased by 280 basis points for the three months ended May 4, 2013 to 29.6%. The increase was primarily due to a 120 basis points increase in ecommerce corporate costs due to the growth in our ecommerce business as a percentage of total sales and a 50 basis points increase in store operating expenses primarily due to deleveraging our fixed costs on a negative 0.7% comparable store sales, as well as a 70 basis points impact of a \$1.1 million charge incurred during the three months ended May 4, 2013 related to the estimated future incentive payments to be paid in conjunction with our acquisition of Blue Tomato and a 40 basis points impact of \$0.6 million in amortization of intangible assets. These increases were partially offset by a 50 basis points decrease in incentive compensation.

#### ***Net Income***

Net income for the three months ended May 4, 2013 was \$2.5 million, or \$0.08 per diluted share, compared with net income of \$4.5 million, or \$0.14 per diluted share, for the three months ended April 28, 2012. Our effective income tax rate for the three months ended May 4, 2013 was 39.0% compared to 41.7% for the three months ended April 28, 2012.

#### ***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 sources of liquidity have 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 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.

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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.

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During fiscal 2013, we expect to spend approximately \$40 million to \$42 million on capital expenditures, a majority of which will relate to leasehold improvements and fixtures for the approximately 60 new stores we plan to open in fiscal 2013 and remodels or relocations of existing stores. There can be no assurance that the number of stores that we actually open in fiscal 2013 will not be different from the number of stores we plan to open, or that actual fiscal 2013 capital expenditures will not differ from this expected amount.

### ***Operating Activities***

Net cash provided by operating activities decreased by \$1.4 million to \$4.4 million for the three months ended May 4, 2013 from \$5.8 million for the three months ended April 28, 2012. 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 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. Changes to our operating cash flows have historically 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 \$4.2 million for the three months ended May 4, 2013, related to \$6.4 million of capital expenditures primarily for new store openings and existing store remodels or relocations, partially offset by \$2.2 million in net sales of marketable securities. Net cash used in investing activities was \$14.6 million for the three months ended April 28, 2012, related to \$8.5 million of capital expenditures primarily for new store openings and the construction of our new home office building in Lynnwood, Washington and \$6.1 million in net purchases of marketable securities.

### ***Financing Activities***

Net cash used in financing activities for the three months ended May 4, 2013 was \$2.8 million, primarily related to \$3.7 million cash paid for the repurchase of common stock, partially offset by proceeds from stock-based compensation exercises and related tax benefits of \$0.9 million. Net cash provided by financing activities for the three months ended April 28, 2012 was \$2.0 million related to proceeds from stock-based compensation 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 and borrowings under our revolving credit facility 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.

We maintain a secured credit agreement with Wells Fargo Bank, N.A., which provides us with a secured revolving credit facility until September 1, 2013 of up to \$25.0 million, which, pursuant to an accordion feature, may be increased to \$35.0 million at our discretion. The secured revolving credit facility provides for the issuance of a standby letter of credit in an amount not to exceed \$5.0 million outstanding at any time and with a term not to exceed 365 days. The commercial line of credit provides for the issuance of a commercial letter of credit in an amount not to exceed \$10.0 million and with terms not to exceed 120 days. The amount of borrowings available at any time under our secured revolving credit facility is reduced by the amount of standby and commercial letters of credit outstanding at that time. There were no outstanding borrowings under the secured revolving credit facility at May 4, 2013 and February 2, 2013. We had open commercial letters of credit outstanding under our secured revolving credit facility of \$0.1 million and \$0.2 million at May 4, 2013 and February 2, 2013. The secured revolving credit facility bears interest at the Daily One Month LIBOR rate plus 1.00%.

Additionally, in conjunction with our acquisition of Blue Tomato, we assumed \$2.3 million in long-term debt, which relates to amounts borrowed to fund operations. At May 4, 2013, the amount of borrowings under this debt was \$2.1 million.

**Table of Contents****Contractual Obligations and Commercial Commitments**

There were no material changes outside the ordinary course of business in our contractual obligations during the three months ended May 4, 2013. The following table summarizes the total amount of future payments due under our contractual obligations at May 4, 2013 (in thousands):

	Total	Fiscal 2013	Fiscal 2014 and Fiscal 2015	Fiscal 2016 and Fiscal 2017	Thereafter
Operating lease obligations (1)	\$ 499,912	\$ 51,550	\$ 137,295	\$ 123,096	\$ 187,971
Purchase obligations (2)	155,407	155,407			
Debt principal and interest (3)	2,239	258	687	511	783
Total (4)	\$ 657,558	\$ 207,215	\$ 137,982	\$ 123,607	\$ 188,754

- (1) Amounts do not include percentage rent, real estate taxes, insurance or common area maintenance charges unless these costs are fixed and determinable.
- (2) We have an option to cancel these commitments with no notice prior to shipment, except for certain private label purchase orders in which we are obligated to repay contractual amounts upon cancellation.
- (3) Amounts include debt principal and scheduled interest payments on our long-term debt assumed in conjunction with our acquisition of Blue Tomato.
- (4) The table above excludes the potential future incentive payments to the sellers and certain employees of Blue Tomato in an aggregate amount of up to 22.1 million Euros (\$28.9 million, using the exchange rate as of May 4, 2013) to the extent that certain financial metrics are met and the sellers and certain employees remain employed with Blue Tomato through April 2015. At May 4, 2013, we estimated that we will be obligated for future incentive payments of 9.0 million Euros (\$11.8 million). See Note 2, Business Combination, in the Notes to Condensed Consolidated Financial Statements found in Item 1 of this Form 10-Q, for additional information related to the future incentive payments.

**Off-Balance Sheet Obligations**

At May 4, 2013, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K.

**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 customer traffic in those malls could cause our sales to be less than expected.***

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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 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 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

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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 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 cannot assure you that we will be able to obtain that financing on acceptable terms or at all.

***If we fail to effectively execute our expansion strategy, we may not be able to successfully open new store locations in a timely manner, if at all, which could have an adverse affect on our net sales and results of operations.***

Our ability to open and operate new stores successfully depends on many factors, including, among others, our ability to:

- identify suitable store locations, the availability of which is outside of our control;
- negotiate acceptable lease terms, including desired tenant improvement allowances;
- source sufficient levels of inventory at acceptable costs to meet the needs of new stores;
- hire, train and retain qualified store personnel;
- successfully integrate new stores into our existing operations; and
- identify and satisfy the merchandise preferences of new geographic areas.

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, a leading European multi-channel retailer for board sports and related apparel and footwear, which was completed in the second quarter of fiscal 2012. 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 the second quarter of 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 our brands, and we may need

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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.

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.

***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 the action sports lifestyle 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.

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

The action sports retail industry historically has been subject to substantial cyclicity. 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 action sports 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% to 85% 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;

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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

inventory shrinkage beyond our historical average rates.

***Significant fluctuations and volatility in the price of cotton, foreign labor costs and other raw materials used in the production of our merchandise may have a material adverse effect on our business, results of operations and financial conditions.***

Increases in the cost of cotton, other raw materials, foreign labor costs and transportation costs used in the production of our merchandise can result in higher costs in the price we pay for this merchandise. The costs for cotton are affected by weather, consumer demand, speculation on the commodities market and other factors that are generally unpredictable and beyond our control. Our gross profit and earnings per share could be adversely affected to the extent that the selling prices of our products do not increase proportionately with the increases in the costs of cotton or other materials. Increasing labor costs and oil-related product costs, such as manufacturing and transportation costs, could also adversely impact gross profit. Additionally, significant changes in the relationship between carrier capacity and shipper demand could increase transportation costs, which could also adversely impact gross profit.

***Most of our merchandise is produced by foreign manufacturers; therefore, the availability and costs of these products may be negatively affected by risks associated with international trade and other international conditions.***

Most of our merchandise is produced by manufacturers around the world. Some of these facilities are located in regions that may be affected by natural disasters, political instability or other conditions that could cause a disruption in trade. Trade restrictions such as increased tariffs or quotas, or both, could also affect the importation of merchandise generally and increase the cost and reduce the supply of merchandise available to us. Any reduction in merchandise available to us or any increase in its cost due to tariffs, quotas or local issues that disrupt trade could have a material adverse effect on our results of operations. Although the prices charged by vendors for the merchandise we purchase are primarily denominated in U.S. dollars, a decline in the relative value of the U.S. dollar to foreign currencies could lead to increased merchandise costs, which could negatively affect our competitive position and our results of operations.

***Our business is susceptible to weather conditions that are out of our control, including the potential risks of unpredictable weather patterns and any weather patterns associated with naturally occurring global climate change, and the resultant unseasonable weather could have a negative impact on our results of operations.***

Our business is susceptible to unseasonable weather conditions. For example, extended periods of unseasonably warm temperatures during the winter season or cool weather during the summer season (including any weather patterns associated with global warming and cooling) could render a portion of our inventory incompatible with those unseasonable conditions. These prolonged unseasonable weather conditions could have a material adverse effect on our business and results of operations.

***We may be unable to compete favorably in the highly competitive retail industry, and if we lose customers to our competitors, our sales could decrease.***

The teenage and young adult retail apparel, footwear, accessories and hardgoods industry is highly competitive. We compete with other retailers for vendors, teenage and young adult customers, suitable store locations, qualified store associates and management personnel. Some of our competitors are larger than we are and have substantially greater financial, marketing, including advanced ecommerce marketing capabilities, and other resources than we do. Additionally, some of our competitors may offer more options for free and/or expedited shipping for ecommerce sales. Direct competition with these and other retailers may increase significantly in the future, which could require us, among other things, to

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lower our prices and could result in the loss of our customers. Current and increased competition could have a material adverse effect on our business, results of operations and financial condition.

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***If we fail to maintain good relationships with vendors or if a vendor is otherwise unable or unwilling to supply us with adequate quantities of their products at acceptable prices, our business and financial performance could suffer.***

Our business is dependent on continued good relations with our vendors. In particular, we believe that we generally are able to obtain attractive pricing and other terms from vendors because we are perceived as a desirable customer, and deterioration in our relationship with our vendors could have a material adverse effect on our business. There can be no assurance that our vendors will provide us with an adequate supply or quality of products or acceptable pricing. Our vendors could discontinue selling to us, raise the prices they charge at any time or allow their merchandise to be discounted by other retailers. There can be no assurance that we will be able to acquire desired merchandise in sufficient quantities on terms acceptable to us in the future. In addition, certain of our vendors sell their products directly to the retail market and therefore compete with us directly and other vendors may decide to do so in the future. There can be no assurance that such vendors will not decide to discontinue supplying their products to us, supply us only less popular or lower quality items, raise the prices they charge us or focus on selling their products directly. In addition, a number of our vendors are smaller, less capitalized companies and are more likely to be impacted by unfavorable general economic and market conditions than larger and better capitalized companies. These smaller vendors may not have sufficient liquidity during economic downturns to properly fund their businesses and their ability to supply their products to us could be negatively impacted. Any inability to acquire suitable merchandise at acceptable prices, or the loss of one or more key vendors, could have a material adverse effect on our business, results of operations and financial condition.

***Our ecommerce operations subject us to numerous risks that could have an adverse effect on our results of operations.***

Our ecommerce operations subject us to certain risks that could have an adverse effect on our operational results, including:

diversion of traffic and sales from our stores;

rapid technological change;

liability for online content; and

risks related to the computer systems that operate our website and related support systems, including computer viruses, electronic break-ins and similar disruptions.

In addition, risks beyond our control, such as governmental regulation of ecommerce, entry of our vendors in the ecommerce business in competition with us, online security breaches and general economic conditions specific to ecommerce could have an adverse effect on our results of operations.

***If we lose key executives or are unable to attract and retain the talent required for our business, our financial performance could suffer.***

Our performance depends largely on the efforts and abilities of our key executives. If we lose the services of one or more of our key executives, we may not be able to successfully manage our business or achieve our growth objectives. As our business grows, we will need to attract and retain additional qualified personnel in a timely manner and we may not be able to do so.

***Our failure to meet our staffing needs could adversely affect our ability to implement our growth strategy and could have a material impact on our results of operations.***

Our success depends in part upon our ability to attract, motivate and retain a sufficient number of qualified employees who understand and appreciate our culture based on a passion for the action sports lifestyle and are able to adequately represent this culture to our customers. Qualified individuals of the requisite caliber, skills and number needed to fill these positions may be in short supply in some areas, and the employee turnover rate in the retail industry is high. Competition for qualified employees could require us to pay higher wages to attract a sufficient number of suitable employees. If we are unable to hire and retain store managers and store associates capable of consistently providing a high level of customer service, as demonstrated by their enthusiasm for our culture and knowledge of our merchandise, our ability to open new stores may be impaired and the performance of our existing and new stores could be materially adversely affected. We are also dependent upon