

AMERICAN EAGLE OUTFITTERS INC

Form 10-Q

May 29, 2014

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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 3, 2014**

**OR**

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

**Commission File Number: 1-33338**

**American Eagle Outfitters, Inc.**

**(Exact name of registrant as specified in its charter)**

|   |  |
|---|--|
| <b>Delaware</b><br><b>(State or other jurisdiction of</b>                                     | <b>No. 13-2721761</b><br><b>(I.R.S. Employer</b> |
| <b>incorporation or organization)</b>   | <b>Identification No.)</b>                       |
| <b>77 Hot Metal Street, Pittsburgh, PA</b><br><b>(Address of principal executive offices)</b> | <b>15203-2329</b><br><b>(Zip Code)</b>           |
| <b>Registrant's telephone number, including area code: (412) 432-3300</b>                     |  |

**Former name, former address and former fiscal year, if changed since last report:**

N/A

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 194,411,830 Common Shares were outstanding at May 27, 2014.

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| <i>(In thousands, except per share amount)</i>                   | May 3,<br>2014<br>(Unaudited) | February 1,<br>2014 | May 4,<br>2013<br>(Unaudited) |
|--|-------------------------------|---------------------|-------------------------------|
| <b>Assets</b>  |                               |                     |                               |
| Current assets:  |                               |                     |                               |
| Cash and cash equivalents  | \$ 327,699                    | \$ 418,933          | \$ 383,175                    |
| Short-term investments   |                               | 10,002              | 113,041                       |
| Merchandise inventory  | 329,249                       | 291,541             | 340,508                       |
| Accounts receivable  | 67,720                        | 73,882              | 55,193                        |
| Prepaid expenses and other                                       | 86,856                        | 83,724              | 97,512                        |
| Deferred income taxes  | 46,057                        | 45,478              | 42,649                        |
| <b>Total current assets</b>                                      | <b>857,581</b>                | <b>923,560</b>      | <b>1,032,078</b>              |
| Property and equipment, at cost, net of accumulated depreciation | 683,749                       | 637,417             | 526,797                       |
| Intangible assets, at cost, net of accumulated amortization      | 49,087                        | 49,271              | 37,931                        |
| Goodwill   | 13,598                        | 13,530              | 11,434                        |
| Non-current deferred income taxes                                | 11,663                        | 24,835              | 23,325                        |
| Other assets   | 36,199                        | 45,551              | 35,479                        |
| <b>Total assets</b>  | <b>\$ 1,651,877</b>           | <b>\$ 1,694,164</b> | <b>\$ 1,667,044</b>           |
| <b>Liabilities and Stockholders Equity</b>                       |                               |                     |                               |
| Current liabilities:   |                               |                     |                               |
| Accounts payable   | \$ 195,703                    | \$ 203,872          | \$ 161,778                    |
| Accrued compensation and payroll taxes                           | 31,219                        | 23,560              | 27,993                        |
| Accrued rent   | 74,023                        | 76,397              | 74,034                        |
| Accrued income and other taxes                                   | 7,756                         | 5,778               | 7,948                         |
| Unredeemed gift cards and gift certificates                      | 35,578                        | 47,194              | 33,435                        |
| Current portion of deferred lease credits                        | 13,155                        | 13,293              | 14,219                        |
| Other liabilities and accrued expenses                           | 38,303                        | 45,384              | 27,728                        |
| <b>Total current liabilities</b>                                 | <b>395,737</b>                | <b>415,478</b>      | <b>347,135</b>                |
| Non-current liabilities:   |                               |                     |                               |
| Deferred lease credits   | 61,562                        | 59,510              | 69,399                        |
| Non-current accrued income taxes                                 | 11,063                        | 16,543              | 19,321                        |
| Other non-current liabilities                                    | 34,357                        | 36,455              | 24,064                        |

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|   |              |              |              |
|---|--------------|--------------|--------------|
| Total non-current liabilities   | 106,982      | 112,508      | 112,784      |
| Commitments and contingencies   |              |              |              |
| Stockholders' equity:   |              |              |              |
| Preferred stock, \$0.01 par value; 5,000 shares authorized; none issued and outstanding   |              |              |              |
| Common stock, \$0.01 par value; 600,000 shares authorized; 249,566 shares issued; 194,409, 193,149 and 192,617 shares outstanding, respectively | 2,496        | 2,496        | 2,496        |
| Contributed capital   | 556,054      | 573,008      | 583,795      |
| Accumulated other comprehensive income  | 16,093       | 12,157       | 28,795       |
| Retained earnings   | 1,542,106    | 1,569,851    | 1,592,706    |
| Treasury stock, 55,157, 56,417 and 56,949 shares, respectively  | (967,591)    | (991,334)    | (1,000,667)  |
| Total stockholders' equity  | 1,149,158    | 1,166,178    | 1,207,125    |
| Total liabilities and stockholders' equity  | \$ 1,651,877 | \$ 1,694,164 | \$ 1,667,044 |

Refer to Notes to Consolidated Financial Statements

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## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Unaudited)

| <i>(In thousands, except per share amounts)</i>                             | 13 Weeks Ended |                |
|---|----------------|----------------|
|   | May 3,<br>2014 | May 4,<br>2013 |
| Total net revenue   | \$ 646,129     | \$ 679,477     |
| Cost of sales, including certain buying, occupancy and warehousing expenses | 420,284        | 415,868        |
| Gross profit  | 225,845        | 263,609        |
| Selling, general and administrative expenses                                | 185,058        | 182,253        |
| Depreciation and amortization expense                                       | 32,362         | 35,539         |
| Operating income  | 8,425          | 45,817         |
| Other income (expense), net   | 686            | (682)          |
| Income before income taxes  | 9,111          | 45,135         |
| Provision for income taxes  | 5,245          | 17,159         |
| Net income  | \$ 3,866       | \$ 27,976      |
| Net income per basic share  | \$ 0.02        | \$ 0.14        |
| Net income per diluted share  | \$ 0.02        | \$ 0.14        |
| Cash dividends per common share   | 0.125          |                |
| Weighted average common shares outstanding basic                            | 194,060        | 192,710        |
| Weighted average common shares outstanding diluted                          | 194,702        | 196,718        |
| Retained earnings, beginning  | \$ 1,569,851   | \$ 1,553,058   |
| Net income  | 3,866          | 27,976         |
| Cash dividends and dividend equivalents                                     | (24,877)       |                |
| Reissuance of treasury stock  | (6,734)        | 11,672         |
| Retained earnings, ending   | \$ 1,542,106   | \$ 1,592,706   |

Refer to Notes to Consolidated Financial Statements

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**AMERICAN EAGLE OUTFITTERS, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**(Unaudited)**

| <i>(In thousands)</i>                    | 13 Weeks Ended |                |
|--|----------------|----------------|
|  | May 3,<br>2014 | May 4,<br>2013 |
| Net income                               | \$ 3,866       | \$ 27,976      |
| Other comprehensive gain (loss):         |                |                |
| Foreign currency translation gain (loss) | 3,936          | (502)          |
| Other comprehensive gain (loss):         | 3,936          | (502)          |
| Comprehensive income                     | \$ 7,802       | \$ 27,474      |

Refer to Notes to Consolidated Financial Statements

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**AMERICAN EAGLE OUTFITTERS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

| <i>(In thousands)</i>  | 13 Weeks Ended  |                 |
|--|-----------------|-----------------|
|  | May 3,<br>2014  | May 4,<br>2013  |
| Operating activities:  |                 |                 |
| Net income   | \$ 3,866        | \$ 27,976       |
| Adjustments to reconcile net income to net cash used for operating activities: |                 |                 |
| Depreciation and amortization  | 32,786          | 35,926          |
| Share-based compensation   | 3,188           | 5,289           |
| Deferred income taxes  | 3,833           | 23,235          |
| Foreign currency transaction loss  | 96              | 640             |
| Changes in assets and liabilities:   |                 |                 |
| Merchandise inventory  | (37,057)        | (8,375)         |
| Accounts receivable  | 5,709           | (8,942)         |
| Prepaid expenses and other   | (2,949)         | (20,497)        |
| Other assets   | (4,354)         | (12,524)        |
| Accounts payable   | 2,112           | (15,811)        |
| Unredeemed gift cards and gift certificates                                    | (11,690)        | (12,981)        |
| Deferred lease credits   | 1,782           | 10,752          |
| Accrued compensation and payroll taxes   | 7,872           | (37,537)        |
| Accrued income and other taxes   | 1,590           | (24,103)        |
| Accrued liabilities  | (11,128)        | (1,732)         |
| <b>Total adjustments</b>   | <b>(8,210)</b>  | <b>(66,660)</b> |
| <b>Net cash used for operating activities</b>                                  | <b>(4,344)</b>  | <b>(38,684)</b> |
| Investing activities:  |                 |                 |
| Capital expenditures for property and equipment                                | (72,015)        | (45,657)        |
| Acquisition of intangible assets   | (640)           | (295)           |
| Purchase of available-for-sale securities                                      |                 | (15,217)        |
| Sale of available-for-sale securities  | 10,002          | 23,778          |
| <b>Net cash used for investing activities</b>                                  | <b>(62,653)</b> | <b>(37,391)</b> |
| Financing activities:  |                 |                 |
| Payments on capital leases   | (1,391)         | (2,564)         |
| Repurchase of common stock as part of publicly announced programs              |                 | (33,051)        |
| Repurchase of common stock from employees                                      | (7,389)         | (23,291)        |
| Net proceeds from stock options exercised                                      | 6,755           | 1,523           |
| Excess tax benefit from share-based payments                                   | 696             | 8,101           |
| Cash dividends paid  | (24,299)        |                 |



|  |                   |                   |
|--|-------------------|-------------------|
| <b>Net cash used for financing activities</b>            | <b>(25,628)</b>   | <b>(49,282)</b>   |
| Effect of exchange rates changes on cash                 | 1,391             | (587)             |
| <b>Net decrease in cash and cash equivalents</b>         | <b>(91,234)</b>   | <b>(125,944)</b>  |
| Cash and cash equivalents beginning of period            | 418,933           | 509,119           |
| Cash and cash equivalents end of period                  | <b>\$ 327,699</b> | <b>\$ 383,175</b> |
| <b>Supplemental disclosure of cash flow information:</b> |                   |                   |
| Cash paid during the period for income taxes             | \$ 7,995          | \$ 33,023         |
| Cash paid during the period for interest                 | \$ 200            | \$ 100            |

Refer to Notes to Consolidated Financial Statements

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**AMERICAN EAGLE OUTFITTERS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Interim Financial Statements**

The accompanying Consolidated Financial Statements of American Eagle Outfitters, Inc. (the Company) at May 3, 2014 and May 4, 2013 and for the 13 week period ended May 3, 2014 and May 4, 2013 have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Certain notes and other information have been condensed or omitted from the interim Consolidated Financial Statements presented in this Quarterly Report on Form 10-Q. Therefore, these Consolidated Financial Statements should be read in conjunction with the Company's Fiscal 2013 Annual Report. In the opinion of the Company's management, all adjustments (consisting of normal recurring adjustments and those described in the footnotes that follow) considered necessary for a fair presentation have been included. The existence of subsequent events has been evaluated through the filing date of this Quarterly Report on Form 10-Q.

As used in this report, all references to we, our and the Company refer to American Eagle Outfitters, Inc. and its wholly owned subsidiaries. American Eagle Outfitters, American Eagle, AEO and the AE Brand refer to our American Eagle Outfitters stores. aerie refers to our aerie by American Eagle® stores. AEO Direct refers to our e-commerce operations, ae.com and aerie.com.

The Company's business is affected by the pattern of seasonality common to most retail apparel businesses. The results for the current and prior periods are not necessarily indicative of future financial results.

**2. Summary of Significant Accounting Policies**

***Principles of Consolidation***

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. At May 3, 2014, the Company operated in one reportable segment.

***Fiscal Year***

The Company's financial year is a 52/53 week year that ends on the Saturday nearest to January 31. As used herein, Fiscal 2015 and Fiscal 2014 refer to the 52 week periods ending January 30, 2016 and January 31, 2015, respectively. Fiscal 2013 refers to the 52 week period ended February 1, 2014.

***Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of our contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, our management reviews the

Company's estimates based on currently available information. Changes in facts and circumstances may result in revised estimates.

***Recent Accounting Pronouncements***

In July 2013, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* ( ASU 2013-11 ). ASU 2013-11 requires an entity to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. ASU No. 2013-11 is effective for financial statements issued for annual reporting periods beginning after December 15, 2013 and interim periods within those years. The Company adopted ASU 2013-11 on February 2, 2014 with no significant impact to its Consolidated Financial Statements.

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### ***Foreign Currency Translation***

In accordance with Accounting Standards Codification ( ASC ) 830, *Foreign Currency Matters*, assets and liabilities denominated in foreign currencies were translated into United States dollars ( USD ) (the reporting currency) at the exchange rates prevailing at the balance sheet date. Revenues and expenses denominated in foreign currencies were translated into USD at the monthly average exchange rates for the period. Gains or losses resulting from foreign currency transactions are included in the results of operations, whereas, related translation adjustments are reported as an element of other comprehensive income in accordance with ASC 220, *Comprehensive Income*.

### ***Revenue Recognition***

Revenue is recorded for store sales upon the purchase of merchandise by customers. The Company's e-commerce operation records revenue upon the estimated customer receipt date of the merchandise. Shipping and handling revenues are included in total net revenue. Sales tax collected from customers is excluded from revenue and is included as part of accrued income and other taxes on the Company's Consolidated Balance Sheets.

Revenue is recorded net of estimated and actual sales returns and deductions for coupon redemptions and other promotions. The Company records the impact of adjustments to its sales return reserve quarterly within total net revenue and cost of sales. The sales return reserve reflects an estimate of sales returns based on projected merchandise returns determined through the use of historical average return percentages.

Revenue is not recorded on the purchase of gift cards. A current liability is recorded upon purchase, and revenue is recognized when the gift card is redeemed for merchandise. Additionally, the Company recognizes revenue on unredeemed gift cards based on an estimate of the amounts that will not be redeemed ( gift card breakage ), determined through historical redemption trends. Gift card breakage revenue is recognized in proportion to actual gift card redemptions as a component of total net revenue. For further information on the Company's gift card program, refer to the Gift Cards caption below.

The Company recognizes royalty revenue generated from its franchise agreements based on a percentage of merchandise sales by the franchisee. This revenue is recorded as a component of total net revenue when earned.

### ***Cost of Sales, Including Certain Buying, Occupancy and Warehousing Expenses***

Cost of sales consists of merchandise costs, including design, sourcing, importing and inbound freight costs, as well as markdowns, shrinkage and certain promotional costs (collectively merchandise costs ) and buying, occupancy and warehousing costs.

Design costs are related to the Company's Design Center operations and include compensation, travel, supplies and samples for our design teams, as well as rent and depreciation for our Design Center. These costs are included in cost of sales as the respective inventory is sold.

Buying, occupancy and warehousing costs consist of compensation, employee benefit expenses and travel for our buyers and certain senior merchandising executives; rent and utilities related to our stores, corporate headquarters, distribution centers and other office space; freight from our distribution centers to the stores; compensation and supplies for our distribution centers, including purchasing, receiving and inspection costs; and shipping and handling costs related to our e-commerce operation. Gross profit is the difference between total net revenue and cost of sales.

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

Selling, general and administrative expenses consist of compensation and employee benefit expenses, including salaries, incentives and related benefits associated with our stores and corporate headquarters. Selling, general and administrative expenses also include advertising costs, supplies for our stores and home office, communication costs, travel and entertainment, leasing costs and services purchased. Selling, general and administrative expenses do not include compensation, employee benefit expenses and travel for our design, sourcing and importing teams, our buyers and our distribution centers as these amounts are recorded in cost of sales.

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***Other Income (Expense), Net***

Other income (expense), net consists primarily of interest income/expense, foreign currency transaction gain/loss and realized investment gains/losses.

***Other-than-Temporary Impairment***

The Company evaluates its investments for impairment in accordance with ASC 320, *Investments Debt and Equity Securities* ( ASC 320 ). ASC 320 provides guidance for det