

Zumiez Inc
Form 10-Q
September 11, 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 AUGUST 3, 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 204th 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 September 3, 2013, there were 30,249,116 shares outstanding of common stock.

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(In thousands)

	August 3, 2013 (Unaudited)	February 2, 2013
Assets		
Current assets		
Cash and cash equivalents	\$ 19,098	\$ 17,579
Marketable securities	75,901	85,593
Receivables	15,597	9,467
Inventories	113,249	77,598
Prepaid expenses and other	11,474	9,192
Deferred tax assets	4,849	3,885
Total current assets	240,168	203,314
Fixed assets, net	124,569	115,474
Goodwill	63,071	64,576
Intangible assets, net	18,727	20,480
Long-term other assets	4,428	5,254
Total long-term assets	210,795	205,784
Total assets	\$ 450,963	\$ 409,098
Liabilities and Shareholders Equity		
Current liabilities		
Trade accounts payable	\$ 53,596	\$ 16,052
Accrued payroll and payroll taxes	9,674	11,057
Income taxes payable	111	6,957
Deferred rent and tenant allowances	5,633	4,901
Other liabilities	20,546	18,232
Total current liabilities	89,560	57,199
Long-term deferred rent and tenant allowances	41,359	36,928
Long-term deferred tax liabilities	3,567	5,544
Long-term debt and other liabilities	7,062	6,006
Total long-term liabilities	51,988	48,478
Total liabilities	141,548	105,677
Commitments and contingencies (Note 5)		
Shareholders equity		
Preferred stock, no par value, 20,000 shares authorized; none issued and outstanding		
Common stock, no par value, 50,000 shares authorized; 30,251 shares issued and outstanding at August 3, 2013 and 30,114 shares issued and outstanding at February 2, 2013	113,569	108,360
Accumulated other comprehensive income	3,238	6,010

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Retained earnings	192,608	189,051
Total shareholders equity	309,415	303,421
Total liabilities and shareholders equity	\$ 450,963	\$ 409,098

See accompanying notes to condensed consolidated financial statements

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	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net sales	\$ 157,858	\$ 135,066	\$ 306,354	\$ 264,965
Cost of goods sold	102,738	88,641	203,262	176,439
Gross profit	55,120	46,425	103,092	88,526
Selling, general and administrative expenses	47,285	42,647	91,228	77,486
Operating profit	7,835	3,778	11,864	11,040
Interest income, net	158	427	373	917
Other (expense) income, net	(174)	611	(320)	628
Earnings before income taxes	7,819	4,816	11,917	12,585
Provision for income taxes	3,080	2,730	4,680	5,972
Net income	\$ 4,739	\$ 2,086	\$ 7,237	\$ 6,613
Basic earnings per share	\$ 0.16	\$ 0.07	\$ 0.24	\$ 0.21
Diluted earnings per share	\$ 0.16	\$ 0.07	\$ 0.24	\$ 0.21
Weighted average shares used in computation of earnings per share:				
Basic	29,842	30,922	29,770	30,847
Diluted	30,232	31,460	30,221	31,439

See accompanying notes to condensed consolidated financial statements

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	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net income	\$ 4,739	\$ 2,086	\$ 7,237	\$ 6,613
Other comprehensive income (loss), net of tax and reclassification adjustments:				
Foreign currency translation	760	(1,897)	(2,645)	(1,801)
Net change in unrealized gain/loss on available-for-sale investments	(110)	(62)	(127)	(102)
Other comprehensive income (loss), net	650	(1,959)	(2,772)	(1,903)
Comprehensive income	\$ 5,389	\$ 127	\$ 4,465	\$ 4,710

See accompanying notes to condensed consolidated financial statements

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CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands)

(Unaudited)

	Common Stock		Accumulated Other Comprehensive Income	Retained Earnings	Total
	Shares	Amount			
Balance at February 2, 2013	30,114	\$ 108,360	\$ 6,010	\$ 189,051	\$ 303,421
Net income				7,237	7,237
Other comprehensive loss, net			(2,772)		(2,772)
Issuance and exercise of stock-based compensation, including tax benefit of \$1,168	302	2,044			2,044
Stock-based compensation expense		3,165			3,165
Repurchase of common stock	(165)			(3,680)	(3,680)
Balance at August 3, 2013	30,251	\$ 113,569	\$ 3,238	\$ 192,608	\$ 309,415

	Common Stock		Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
	Shares	Amount			
Balance at January 28, 2012	31,170	\$ 99,412	\$ 135	\$ 172,730	\$ 272,277
Net income				6,613	6,613
Other comprehensive loss, net			(1,903)		(1,903)
Issuance and exercise of stock-based compensation, including tax benefit of \$2,065	183	2,413			2,413
Stock-based compensation expense		3,037			3,037
Balance at July 28, 2012	31,353	\$ 104,862	\$ (1,768)	\$ 179,343	\$ 282,437

See accompanying notes to condensed consolidated financial statements

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

	Six Months Ended	
	August 3, 2013	July 28, 2012
Cash flows from operating activities:		
Net income	\$ 7,237	\$ 6,613
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion	12,694	10,658
Deferred taxes	(1,384)	(1,177)
Stock-based compensation expense	3,165	3,037
Excess tax benefit from stock-based compensation	(1,168)	(2,065)
Lease termination costs	100	920
Other	182	(183)
Changes in operating assets and liabilities:		
Receivables	(5,457)	(4,452)
Inventories	(36,064)	(26,896)
Prepaid expenses and other	(3,057)	(1,904)
Trade accounts payable	35,315	33,583
Accrued payroll and payroll taxes	(1,344)	(2,156)
Income taxes payable	(6,415)	(4,503)
Deferred rent and tenant allowances	5,263	4,158
Other liabilities	809	(1,120)
Net cash provided by operating activities	9,876	14,513
Cash flows from investing activities:		
Additions to fixed assets	(14,505)	(21,904)
Acquisitions, net of cash acquired		(69,685)
Purchases of marketable securities and other investments	(38,991)	(65,655)
Sales and maturities of marketable securities and other investments	47,760	138,555
Net cash used in investing activities	(5,736)	(18,689)
Cash flows from financing activities:		
Payments on long-term debt	(153)	(109)
Repurchase of common stock	(4,310)	
Proceeds from exercise of stock-based compensation, net of withholding tax payments	876	347
Excess tax benefit from stock-based compensation	1,168	2,065
Net cash (used in) provided by financing activities	(2,419)	2,303
Effect of exchange rate changes on cash and cash equivalents	(202)	(296)
Net increase (decrease) in cash and cash equivalents	1,519	(2,169)
Cash and cash equivalents, beginning of period	17,579	14,779

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Cash and cash equivalents, end of period	\$ 19,098	\$ 12,610
Supplemental disclosure on cash flow information:		
Cash paid during the period for income taxes	\$ 12,428	\$ 11,624
Accrual for purchases of fixed assets	7,514	7,355
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 August 3, 2013, we operated 529 stores; 495 in the United States (U.S.), 27 in Canada and seven 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 six months of fiscal 2013 was the 26-week period ended August 3, 2013. The first six months of fiscal 2012 was the 26-week period ended July 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 seasonality and other factors.

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

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

Recent Accounting Standards In 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.

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 plan to 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.

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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 (\$29.2 million, using the exchange rate as of August 3, 2013) to the extent that certain financial metrics are met for the fiscal year ending 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 (\$22.6 million) is payable in cash, while 5.0 million Euros (\$6.6 million) is payable in shares of our common stock. We account for the estimated future incentive payments as compensation expense, which is included in selling, general and administrative expense on the condensed consolidated statements of income, and recognize this amount ratably over the term of service through April 2015. At August 3, 2013, we estimated we will be obligated for future incentive payments of 9.0 million Euros (\$11.9 million). For the three and six months ended August 3, 2013, we recorded an expense for future incentive payments of \$1.0 million and \$2.1 million. For the three and six months ended July 28, 2012, we recorded an expense for future incentive payments of \$0.7 million.

Pro Forma Financial Information The following pro forma financial information shows the results of operations for the three and six months ended July 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 of Blue Tomato (using our initial estimate of future incentive payments of 18.1 Euros). The adjustments also reflect the income tax effect of the pro forma adjustments.

The amounts also reflect the removal of the following non-recurring, transaction related costs and related income tax effect from fiscal 2012 pro forma results: (i) the transaction costs of \$1.9 million associated with the Blue Tomato acquisition, (ii) the charge related to the fair value adjustment to acquisition date inventory of \$0.5 million and (iii) the foreign currency transaction gain of \$0.5 million associated with the foreign currency fluctuations associated with the acquisition of Blue Tomato.

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 July 28, 2012	Six Months Ended July 28, 2012
Net sales	\$ 137,783	\$ 276,096
Net income	\$ 930	\$ 3,149

3. Intangible Assets

The following table summarizes the gross carrying amount, accumulated amortization and the net carrying amount of intangible assets at August 3, 2013 and February 2, 2013 (in thousands):

	August 3, 2013			Weighted- Average Useful Life
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	
Trade names and trademarks	\$ 14,293	\$	\$ 14,293	Indefinite-lived
Developed technology	3,970	1,434	2,536	3 years
Customer relationships	2,942	1,044	1,898	3 years
Total intangible assets	\$ 21,205	\$ 2,478	\$ 18,727	

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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 or six months ended August 3, 2013 and for the three or six months ended July 28, 2012. Amortization expense of intangible assets for the three and six months ended August 3, 2013 was \$0.6 million and \$1.1 million. Amortization expense of intangible assets for the three and six months ended July 28, 2012 was \$0.2 million. Amortization expense of 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 August 3, 2013 and February 2, 2013 (in thousands):

	August 3, 2013			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	\$ 13,826	\$	\$	\$ 13,826
Money market funds	3,151			3,151
State and local government securities	2,121			2,121
Total cash and cash equivalents	19,098			19,098
Marketable securities:				
Corporate debt securities	1,023	42		1,065
State and local government securities	70,446	44	(317)	70,173
Variable-rate demand notes	5,475			5,475
Total marketable securities	\$ 76,944	\$ 86	\$ (317)	\$ 76,713
Less: Long-term marketable securities (1)				(812)
Total current marketable securities				\$ 75,901

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	February 2, 2013			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	\$ 6,271	\$	\$	\$ 6,271
Money market funds	8,305			8,305
State and local government securities	3,003			3,003
Total cash and cash equivalents	17,579			17,579
Marketable securities:				
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
Total marketable securities	\$ 86,456	\$ 160	\$ (179)	\$ 86,437
Less: Long-term marketable securities (1)				(844)
Total current marketable securities				\$ 85,593

- (1) At August 3, 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.

The following tables summarize the gross unrealized holding losses and fair value for investments in an unrealized loss position at August 3, 2013 and February 2, 2013, and the length of time that individual securities have been in a continuous loss position (in thousands):

	August 3, 2013					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Marketable securities:						
State and local government securities	20,924	(129)	3,187	(188)	24,111	(317)
Total marketable securities	\$ 20,924	\$ (129)	\$ 3,187	\$ (188)	\$ 24,111	\$ (317)

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

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We did not record a realized loss for other-than-temporary impairments during the three and six months ended August 3, 2013 and July 28, 2012. At August 3, 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 and six months ended August 3, 2013 and July 28, 2012 is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Base rent expense	\$ 13,498	\$ 11,631	\$ 26,407	\$ 22,692
Contingent and other rent expense (1)	8,231	7,244	16,144	14,300
Total rent expense	\$ 21,729	\$ 18,875	\$ 42,551	\$ 36,992

(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 August 3, 2013 are as follows (in thousands):

Fiscal 2013	\$ 35,322
Fiscal 2014	70,989
Fiscal 2015	69,290
Fiscal 2016	66,460
Fiscal 2017	60,123
Thereafter	202,205
Total	\$ 504,389

Purchase Commitments At August 3, 2013, we had outstanding purchase orders to acquire merchandise from vendors of \$134.4 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 August 3, 2013 and February 2, 2013 was \$1.5 million and \$1.2 million.

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 August 3, 2013 and February 2, 2013 (in thousands):

	August 3, 2013		
	Level 1	Level 2	Level 3
Cash equivalents:			
Money market funds	\$ 3,151	\$	\$
State and local government securities		2,121	
Marketable securities:			
Corporate debt securities		1,065	
State and local government securities		69,361	
Variable-rate demand notes		5,475	
Long-term other assets:			
State and local government securities			812
Equity investments			905
Total	\$ 3,151	\$ 78,022	\$ 1,717

	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
Total	\$ 8,305	\$ 88,596	\$ 1,903

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 and six months ended August 3, 2013 and July 28, 2012.

Table of Contents**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 six months ended August 3, 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 August 3, 2013, there remains \$12.5 million available to repurchase shares under this program.

Comprehensive Income (Loss) Other comprehensive income (loss) by component and the related tax effects for the three and six months ended August 3, 2013 and July 28, 2012 is as follows (in thousands):

	Three Months Ended					
	August 3, 2013			July 28, 2012		
	Before-Tax Amount	Tax Expense or Benefit	Net-of-Tax Amount	Before-Tax Amount	Tax Expense or Benefit	Net-of-Tax Amount
Foreign currency translation adjustments (1)	\$ 760	\$	\$ 760	\$ (1,897)	\$	\$ (1,897)
Unrealized losses on available-for-sale investments:						
Unrealized holding gains (losses) arising during period	(197)	74	(123)	15	(6)	9
Reclassification adjustment for (gains) losses realized in net income	18	(5)	13	(117)	46	(71)
Net unrealized losses on available-for-sale investments	(179)	69	(110)	(102)	40	(62)
Other comprehensive income (loss)	\$ 581	\$ 69	\$ 650	\$ (1,999)	\$ 40	\$ (1,959)

	Six Months Ended					
	August 3, 2013			July 28, 2012		
	Before-Tax Amount	Tax Expense or Benefit	Net-of-Tax Amount	Before-Tax Amount	Tax Expense or Benefit	Net-of-Tax Amount
Foreign currency translation adjustments (1)	\$ (2,645)	\$	\$ (2,645)	\$ (1,801)	\$	\$ (1,801)
Unrealized losses on available-for-sale investments:						
Unrealized losses arising during period	(210)	78	(132)	(50)	19	(31)
Reclassification adjustment for (gains) losses realized in net income	4	1	5	(117)	46	(71)
Net unrealized losses on available-for-sale investments	(206)	79	(127)	(167)	65	(102)
Other comprehensive loss	\$ (2,851)	\$ 79	\$ (2,772)	\$ (1,968)	\$ 65	\$ (1,903)

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- (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 (Loss) The changes in the balances of each component of accumulated other comprehensive income (loss) for the three and six months ended August 3, 2013 and July 28, 2012 are as follows (in thousands):

	Foreign currency translation adjustments	Net unrealized gains (losses) on available-for-sale investments	Accumulated other comprehensive income (loss)
Three months ended August 3, 2013:			
Balance at May 4, 2013	\$ 2,616	\$ (28)	\$ 2,588
Other comprehensive income before reclassifications, net of tax	760	(123)	637
Reclassifications recorded in:			
Other (expense) income, net		18	18
Provision for income taxes		(5)	(5)
Total reclassifications from accumulated other comprehensive income (loss), net of taxes		13	13
Balance at August 3, 2013	\$ 3,376	\$ (138)	\$ 3,238
Three months ended July 28, 2012:			
Balance at April 28, 2012	\$ 77	\$ 114	\$ 191
Other comprehensive loss before reclassifications, net of tax	(1,897)	9	(1,888)
Reclassifications recorded in:			
Other (expense) income, net		(117)	(117)
Provision for income taxes		46	46
Total reclassifications from accumulated other comprehensive income (loss), net of taxes		(71)	(71)
Balance at July 28, 2012	\$ (1,820)	\$ 52	\$ (1,768)
Six months ended August 3, 2013:			
Balance at February 2, 2013	\$ 6,021	\$ (11)	\$ 6,010
Other comprehensive loss before reclassifications, net of tax	(2,645)	(132)	(2,777)
Reclassifications recorded in:			
Other (expense) income, net		4	4
Provision for income taxes		1	1
Total reclassifications from accumulated other comprehensive income (loss), net of taxes		5	5
Balance at August 3, 2013	\$ 3,376	\$ (138)	\$ 3,238
Six months ended July 28, 2012:			
Balance at January 28, 2012	\$ (19)	\$ 154	\$ 135

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Other comprehensive loss before reclassifications, net of tax	(1,801)	(31)	(1,832)
Reclassifications recorded in:			
Other (expense) income, net		(117)	(117)
Provision for income taxes		46	46
Total reclassifications from accumulated other comprehensive income (loss), net of taxes		(71)	(71)
Balance at July 28, 2012	\$ (1,820)	\$ 52	\$ (1,768)

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.

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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 six months ended August 3, 2013 and July 28, 2012:

	Six Months Ended	
	August 3, 2013	July 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 six months ended August 3, 2013 (in thousands except grant date weighted-average fair value):

	Restricted Stock	Grant Date Weighted-Average Fair Value	Intrinsic Value (1)
Outstanding at February 2, 2013	382	\$ 23.97	
Granted year to date	193	\$ 25.38	
Vested year to date	(189)	\$ 19.52	
Forfeited year to date	(11)	\$ 28.12	
Outstanding at August 3, 2013	375	\$ 26.81	\$ 10,654

(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. The following table summarizes our stock option activity for the six months ended August 3, 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	(110)	\$ 6.39		
Outstanding at August 3, 2013	757	\$ 19.69	4.55	\$ 7,852
Exercisable at August 3, 2013	637	\$ 18.42	3.80	\$ 7,504

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(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 \$1.7 million and \$3.2 million of total stock-based compensation expense for the three and six months ended August 3, 2013. We recorded \$1.4 million and \$3.0 million of total stock-based compensation expense for the three and six months ended July 28, 2012.

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At August 3, 2013, there was \$11.4 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 1.2 years.

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 August 3, 2013 and July 28, 2012 (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net income	\$ 4,739	\$ 2,086	\$ 7,237	\$ 6,613
Weighted average common shares for basic earnings per share	29,842	30,922	29,770	30,847
Dilutive effect of stock options and restricted stock	390	538	451	592
Weighted average common shares for diluted earnings per share	30,232	31,460	30,221	31,439
Basic earnings per share	\$ 0.16	\$ 0.07	\$ 0.24	\$ 0.21
Diluted earnings per share	\$ 0.16	\$ 0.07	\$ 0.24	\$ 0.21

Total anti-dilutive common stock options not included in the calculation of diluted earnings per share were approximately 0.2 million and 0.3 million for the three and six months ended August 3, 2013. Total anti-dilutive common stock options not included in the calculation of diluted earnings per share were approximately 0.1 million for the three and six months ended July 28, 2012.

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.

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):

	Employee benefit costs	Lease termination costs (1)	Other exit costs	Total
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		(289)		(289)
Adjustments		100		100
August 3, 2013 (3)	\$	\$ 982	\$	\$ 982

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- (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 August 3, 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 and 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 an 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 are included in the calculation of comparable store sales beginning in 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. Operating profit is the difference between gross profit and selling, general and administrative expenses. 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:

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	65.1	65.6	66.3	66.6
Gross profit	34.9	34.4	33.7	33.4
Selling, general and administrative expenses	29.9	31.6	29.8	29.2

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Operating profit	5.0	2.8	3.9	4.2
Interest and other income, net	0.0	0.8	0.0	0.5
Earnings before income taxes	5.0	3.6	3.9	4.7
Provision for income taxes	2.0	2.1	1.5	2.2
Net income	3.0%	1.5%	2.4%	2.5%

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Three Months (13 weeks) Ended August 3, 2013 Compared With Three Months (13 weeks) Ended July 28, 2012

Net Sales

Net sales were \$157.9 million for the three months ended August 3, 2013 compared to \$135.1 million for the three months ended July 28, 2012, an increase of \$22.8 million or 16.9%. The increase reflected the net addition of 52 stores (57 new stores offset by five store closures) subsequent to July 28, 2012, the impact of the calendar shift to include a week of the back-to-school season in the three months ended August 3, 2013 compared to the prior year quarter, Blue Tomato sales during the three months ended August 3, 2013 that were not comparable to the prior year quarter and a comparable store sales increase of 0.9% for the three months ended August 3, 2013.

The 0.9% increase in comparable stores sales was a result of a 19.1% increase for our comparable ecommerce sales, partially offset by a 0.4% decrease for our comparable in-store sales. Total ecommerce sales represented 8.8% of sales for the three months ended August 3, 2013, compared to 6.9% of sales for the three months ended July 28, 2012, increasing due to Blue Tomato ecommerce sales that were not comparable to the prior year quarter and the growth in comparable ecommerce sales mentioned above. The increase in comparable store sales was primarily driven by an increase in dollars per transaction, partially offset by a decline in comparable store transactions. Dollars per transaction increased due to an increase in units per transaction, partially offset by a decrease in average unit retail. Comparable store sales increases in hardgoods, junior's clothing and footwear were partially offset by comparable store sales decreases in accessories, men's clothing and boy's clothing. For information as to how we define comparable stores, see "General" above.

Gross Profit

Gross profit was \$55.1 million for the three months ended August 3, 2013 compared to \$46.4 million for the three months ended July 28, 2012, an increase of \$8.7 million, or 18.7%. As a percent of net sales, gross profit increased 50 basis points for the three months ended August 3, 2013 to 34.9%. The increase was primarily driven by an 80 basis points benefit due to prior year costs related to exit costs and other charges related to the relocation of our ecommerce fulfillment center and a step-up in inventory to estimated fair value in conjunction with our acquisition of Blue Tomato. This increase was partially offset by an increase in ecommerce related costs due to ecommerce sales increasing as a percent of total sales.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were \$47.3 million for the three months ended August 3, 2013 compared to \$42.6 million for the three months ended July 28, 2012, an increase of \$4.7 million, or 10.9%. SG&A expenses as a percent of net sales decreased by 170 basis points for the three months ended August 3, 2013 to 29.9%. The decrease was primarily driven by a 170 basis points benefit due to prior year costs related to transaction costs incurred in conjunction with our acquisition of Blue Tomato and exit costs and other charges related to the relocation of our home office. The decrease in SG&A expenses as a percent of net sales was also impacted by a decrease in incentive compensation. These decreases were partially offset by an increase in ecommerce corporate costs due to the growth and investments in our ecommerce business as a percent of total sales.

Net Income

Net income for the three months ended August 3, 2013 was \$4.7 million, or \$0.16 per diluted share, compared with net income of \$2.1 million, or \$0.07 per diluted share, for the three months ended July 28, 2012. Our effective income tax rate for the three months ended August 3, 2013 was 39.4% compared to 56.7% for the three months ended July 28, 2012. Our effective tax rate for the three months ended July 28, 2012 was adversely impacted by the tax effects of the acquisition of Blue Tomato.

Six Months (26 weeks) Ended August 3, 2013 Compared With Six Months (26 weeks) Ended July 28, 2012

Net Sales

Net sales were \$306.4 million for the six months ended August 3, 2013 compared to \$265.0 million for the six months ended July 28, 2012, an increase of \$41.4 million or 15.6%. The increase reflected the net addition of 52 stores (57 new stores offset by five store closures) subsequent to July 28, 2012, Blue Tomato sales during the six months ended August 3, 2013 that were not comparable to the prior year, the impact of the calendar shift to include a week of the back-to-school season in the six months ended August 3, 2013 compared to the prior year and a comparable store sales increase of 0.2% for the six months ended August 3, 2013.

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The 0.2% increase in comparable stores sales was a result of a 16.1% increase for our comparable ecommerce sales, partially offset by a 1.0% decrease for our comparable in-store sales. Total ecommerce sales represented 10.2% of sales for the six months ended August 3, 2013, compared to 7.3% of sales for the six months ended July 28, 2012, increasing due to Blue Tomato ecommerce sales that were not comparable to the prior year and the growth in comparable ecommerce sales mentioned above. The increase in comparable store sales was primarily driven by an increase in dollars per transaction, partially offset by a decline in comparable store transactions. Dollars per transaction increased due to an increase in units per transaction, partially offset by a decrease in average unit retail. Comparable store sales increases in hardgoods and junior's clothing were partially offset by comparable store sales decreases in men's clothing, accessories, boy's clothing and footwear. For information as to how we define comparable stores, see General above.

Gross Profit

Gross profit was \$103.1 million for the six months ended August 3, 2013 compared to \$88.5 million for the six months ended July 28, 2012, an increase of \$14.6 million, or 16.5%. As a percent of net sales, gross profit increased 30 basis points for the six months ended August 3, 2013 to 33.7%. The increase was primarily driven by a 50 basis points benefit due to prior year costs related to exit costs and other charges related to the relocation of our ecommerce fulfillment center and a step-up in inventory to estimated fair value in conjunction with our acquisition of Blue Tomato. This increase was partially offset by an increase in ecommerce related costs due to ecommerce sales increasing as a percent of total sales.

Selling, General and Administrative Expenses

SG&A expenses were \$91.2 million for the six months ended August 3, 2013 compared to \$77.5 million for the six months ended July 28, 2012, an increase of \$13.7 million, or 17.7%. SG&A expenses as a percent of net sales increased by 60 basis points for the six months ended August 3, 2013 to 29.8%. The increase was primarily due to an increase in ecommerce corporate costs due to the growth and investments in our ecommerce business as a percent of total sales and a 40 basis points impact of the charge related to the estimated future incentive payments to be paid in conjunction with our acquisition of Blue Tomato. These increases were partially offset by an 100 basis points benefit due to prior year costs related to transaction costs incurred in conjunction with our acquisition of Blue Tomato and exit costs and other charges related to the relocation of our home office. The decrease in SG&A expenses as a percent of net sales was also impacted by a decrease in incentive compensation.

Net Income

Net income for the six months ended August 3, 2013 was \$7.2 million, or \$0.24 per diluted share, compared with net income of \$6.6 million, or \$0.21 per diluted share, for the six months ended July 28, 2012. Our effective income tax rate for the six months ended August 3, 2013 was 39.3% compared to 47.5% for the six months ended July 28, 2012. Our effective tax rate for the six months ended July 28, 2012 was adversely impacted by the tax effects of the acquisition of Blue Tomato.

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.

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

During fiscal 2013, we expect to spend approximately \$36 million to \$38 million on capital expenditures, a majority of which will relate to leasehold improvements and fixtures for the 58 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.

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Operating Activities

Net cash provided by operating activities decreased by \$4.6 million to \$9.9 million for the six months ended August 3, 2013 from \$14.5 million for the six months ended July 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 \$5.7 million for the six months ended August 3, 2013, related to \$14.5 million of capital expenditures primarily for new store openings and existing store remodels or relocations, partially offset by \$8.8 million in net sales of marketable securities. Net cash used in investing activities was \$18.7 million for the six months ended July 28, 2012, related to \$69.7 million for the acquisition of Blue Tomato (net of cash acquired) and \$21.9 million of capital expenditures primarily for new store openings and the construction of our new home office building in Lynnwood, Washington, partially offset by \$72.9 million in net sales of marketable securities.

Financing Activities

Net cash used in financing activities for the six months ended August 3, 2013 was \$2.4 million, primarily related to \$4.3 million cash paid for the repurchase of common stock, partially offset by proceeds from stock-based compensation exercises and related tax benefits of \$2.0 million. Net cash provided by financing activities for the six months ended July 28, 2012 was \$2.3 million related primarily to proceeds from stock-based compensation exercises and the 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, 2014 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 August 3, 2013 and February 2, 2013. We had open commercial letters of credit outstanding under our secured revolving credit facility of \$1.0 million and \$0.2 million at August 3, 2013 and February 2, 2013. The secured revolving credit facility bears interest at the Daily Three 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 August 3, 2013, the amount of borrowings under this debt was \$2.0 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 six months ended August 3, 2013. The following table summarizes the total amount of future payments due under our contractual obligations at August 3, 2013 (in thousands):

	Total	Fiscal 2013	Fiscal 2014 and Fiscal 2015	Fiscal 2016 and Fiscal 2017	Thereafter
Operating lease obligations (1)	\$ 504,389	\$ 35,322	\$ 140,279	\$ 126,583	\$ 202,205
Purchase obligations (2)	134,451	134,451			
Debt principal and interest (3)	2,176	174	695	516	791
Total (4)	\$ 641,016	\$ 169,947	\$ 140,974	\$ 127,099	\$ 202,996

- (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 (\$29.2 million, using the exchange rate as of August 3, 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 August 3, 2013, we estimated that we will be obligated for future incentive payments of 9.0 million Euros (\$11.9 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 August 3, 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 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.

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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.

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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 to build brand awareness in the markets. Furthermore, we have limited experience with the legal and regulatory environments and market practices outside of the U.S. and cannot guarantee that we will be able to penetrate or successfully operate in international markets. We also expect to incur additional costs in complying with applicable foreign laws and regulations as they pertain to both our products and our operations.

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

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 cyclicalities. 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;

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calendar shifts of holiday or seasonal periods;

changes in our merchandise mix;

timing of promotional events;

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

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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.

Required disclosures regarding conflict minerals could have a negative impact on our results of operations.

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC promulgated final rules regarding disclosure of the use of certain minerals (tantalum, tin, gold and tungsten) known as conflict minerals, which are mined from the Democratic Republic of the Congo and adjoining countries, as well as procedures regarding a manufacturer's efforts to prevent the sourcing of such minerals and metals produced from those minerals. These new requirements will require due diligence efforts for the 2013 calendar year, with initial disclosure requirements effective in May 2014. There may be costs associated with complying with the disclosure requirements, such as costs related to determining the source of certain minerals used in our private label merchandise, as well as costs of possible changes to products, processes or sources of supply as a consequence of such verification activities. We may also face reputational challenges if we are unable to verify the origins for any or all conflict minerals used in our private label merchandise, or if we are unable to certify that our products are conflict free.

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.

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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

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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 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.

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.

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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

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upon temporary personnel to adequately staff our stores and distribution and ecommerce fulfillment centers particularly during busy periods such as the back-to-school and winter holiday seasons. There can be no assurance that we will receive adequate assistance from our temporary personnel, or that there will be sufficient sources of temporary personnel. Although none of our employees are currently covered by collective bargaining agreements, we cannot guarantee that our employees will not elect to be represented by labor unions in the future, which could increase our labor costs and could subject us to the risk of work stoppages and strikes. Any such failure to meet our staffing needs, any material increases in employee turnover rates, any increases in labor costs or any work stoppages, interruptions or strikes could have a material adverse effect on our business or results of operations.

Our business could suffer with the closure or disruption of any of our distribution or ecommerce fulfillment centers.

Domestically, we rely on a single distribution center located in Corona, California to receive, store and distribute the vast majority of our merchandise to our domestic stores and we rely on a single ecommerce fulfillment center located in Edwardsville, Kansas to ship merchandise purchased on the www.zumiez.com website. Internationally, we operate a combined distribution and ecommerce fulfillment center located in Graz, Austria that support our Blue Tomato ecommerce and store operations in Europe and we operate a distribution center located in Delta, British Columbia to distribute our merchandise to our Canadian stores. As a result, a natural disaster or other catastrophic event that affects one of the regions where we operate these centers could significantly disrupt our operations and have a material adverse effect on our business, results of operations and financial condition.

We are required to make substantial rental payments under our operating leases and any failure to make these lease payments when due could have a material adverse effect on our business and growth plans.

Payments under operating leases account for a significant portion of our operating expenses and has historically been our third largest expense behind cost of sales and our employee related costs. Total rent expense, including contingent rent (or percentage rent) based on sales of some of our stores, real estate taxes, insurance and common area maintenance charges, was \$42.6 million and \$37.0 million for the six months ended August 3, 2013 and July 28, 2012. At August 3, 2013, we were committed to property owners for minimum operating leases obligations for \$504.4 million. In addition, substantially all of our store leases provide for contingent rent payments based on sales of the respective stores, as well as real estate taxes, insurance and common area maintenance charges. These amounts generally escalate each year. We expect that any new stores we open will also be leased by us under operating leases, which will further increase our operating lease expenses.

Our substantial operating lease obligations could have significant negative consequences, including:

increasing our vulnerability to general adverse economic and industry conditions;

limiting our ability to obtain additional financing;

requiring that a substantial portion of our available cash be applied to pay our rental obligations, thus reducing cash available for other purposes; and

limiting our flexibility in planning for or reacting to changes in our business or in the industry in which we compete, and placing us at a disadvantage with respect to some of our competitors.

We depend on cash flow from operations to pay our lease expenses and to fulfill our other cash needs. If our business does not generate sufficient cash flow from operating activities, and sufficient funds are not otherwise available to us from borrowings under bank loans or from other sources, we may not be able to service our operating lease expenses, grow our business, respond to competitive challenges or fund our other liquidity and capital needs, which could have a material adverse effect on our business.

The terms of our primary credit facility impose operating and financial restrictions on us that may impair our ability to respond to changing business and economic conditions. These restrictions could have a significant adverse impact on our business. Additionally, our business could suffer if our ability to acquire financing is reduced or eliminated.

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We maintain a secured credit agreement with Wells Fargo Bank, N.A., which provides us with a secured revolving credit facility until September 1, 2014 of up to \$25.0 million, which, pursuant to an accordion feature, may be increased to \$35.0 million at our discretion. The credit agreement contains a number of restrictions and covenants that generally limit our ability to, among other things, (1) incur additional debt, (2) undergo a change in ownership and (3) enter into certain transactions. The credit agreement also contains financial covenants that require us to meet certain specified financial tests and ratios, including, a maximum net income after taxes of not less than one dollar on a trailing four-quarter basis provided, that, there shall be added to net income all charges for impairment of goodwill and other intangibles and up to an aggregate of \$5.0 million of store asset impairment, and a minimum

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quick ratio of 1.25. The quick ratio is defined as our cash and near cash equivalents plus certain defined receivables divided by the outstanding borrowings. Our accounts receivable, general intangibles, inventory and equipment have been pledged to secure our obligations under the credit agreement. We must also provide financial information and statements to our lender. We were in compliance with all such covenants at August 3, 2013. There were no outstanding borrowings under the secured revolving credit facility at August 3, 2013 and February 2, 2013. We had open commercial letters of credit outstanding under our secured revolving credit facility of \$1.0 million and \$0.2 million at August 3, 2013 and February 2, 2013.

A breach of any of these restrictive covenants or our inability to comply with the required financial tests and ratios could result in a default under the credit agreement. If a default occurs, the lender may elect to declare all borrowings outstanding, together with accrued interest and other fees, to be immediately due and payable. If we are unable to repay outstanding borrowings when due, whether at their maturity or if declared due and payable by the lender following a default, the lender has the right to proceed against the collateral granted to it to secure the indebtedness. As a result, any breach of these covenants or failure to comply with these tests and ratios could have a material adverse effect on us. There can be no assurance that we will not breach the covenants or fail to comply with the tests and ratios in our credit agreement or any other debt agreements we may enter into in the future and, if a breach occurs, there can be no assurance that we will be able to obtain necessary waivers or amendments from the lenders.

The restrictions contained in our credit agreement could: (1) limit our ability to plan for or react to market conditions or meet capital needs or otherwise restrict our activities or business plans; and (2) adversely affect our ability to finance our operations, strategic acquisitions, investments or other capital needs or to engage in other business activities that would be in our interest.

Additionally, in the current economic environment, we cannot be assured that our borrowing relationship with our lenders will continue or that our lenders will remain able to support their commitments to us in the future. If our lenders fail to do so, then we may not be able to secure alternative financing on commercially reasonable terms, or at all.

Our business could suffer if a manufacturer fails to use acceptable labor practices.

We do not control our vendors or the manufacturers that produce the products we buy from them, nor do we control the labor practices of our vendors and these manufacturers. The violation of labor or other laws by any of our vendors or these manufacturers, or the divergence of the labor practices followed by any of our vendors or these manufacturers from those generally accepted as ethical in the U.S., could interrupt, or otherwise disrupt, the shipment of finished products to us or damage our reputation. Any of these, in turn, could have a material adverse effect on our financial condition and results of operations. In that regard, most of the products we sell are manufactured overseas, primarily in Asia and Central America, which may increase the risk that the labor practices followed by the manufacturers of these products may differ from those considered acceptable in the U.S.

Additionally, our products are subject to regulation of and regulatory standards set by various governmental authorities with respect to quality and safety. Regulations and standards in this area are currently in place. These regulations and standards may change from time to time. Our inability to comply on a timely basis with regulatory requirements could result in significant fines or penalties, which could adversely affect our reputation and sales. Issues with the quality and safety of merchandise we sell, regardless of our culpability, or customer concerns about such issues, could result in damage to our reputation, lost sales, uninsured product liability claims or losses, merchandise recalls and increased costs.

Our failure to adequately anticipate a correct mix of private label merchandise may have a material adverse effect on our business.

Sales from private label merchandise account for approximately 15% to 20% of our net sales and generally carry higher gross margins than our other merchandise. We may take steps to increase the percentage of net sales of private label merchandise in the future, although there can be no assurance that we will be able to achieve increases in private label merchandise sales as a percentage of net sales. Our failure to anticipate, identify and react in a timely manner to fashion trends with our private label merchandise, could have a material adverse effect on our comparable store sales, financial condition and results of operations.

If our information systems hardware or software fails to function effectively or does not scale to keep pace with our planned growth, our operations could be disrupted and our financial results could be harmed.

We are continuing to make investments to improve our information systems infrastructure. If our information systems and software do not work effectively, this could adversely impact the promptness and accuracy of our transaction processing, financial accounting and reporting and our ability to manage our business and properly forecast operating results and cash requirements. Additionally, we rely on third-party service providers for certain information systems functions. If a service provider fails to provide the data quality, communications capacity or services we require, the failure could interrupt our services and could have a material adverse effect on our business, financial condition and results of

operations. To manage the

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anticipated growth of our operations and personnel, we may need to continue to improve our operational and financial systems, transaction processing, procedures and controls, and in doing so could incur substantial additional expenses that could impact our financial results.

The security of our databases that contain personal information of our retail customers could be breached, which could subject us to adverse publicity, litigation and expenses. In addition, if we are unable to comply with security standards created by the credit card industry, our operations could be adversely affected.

Database privacy, network security and identity theft are matters of growing public concern. In an attempt to prevent unauthorized access to our network and databases containing confidential, third-party information, we have installed privacy protection systems, devices and activity monitoring on our networks. Nevertheless, if unauthorized parties gain access to our networks or databases, they may be able to steal, publish, delete or modify our private and sensitive third-party information. In such circumstances, we could be held liable to our customers or other parties or be subject to regulatory or other actions for breaching privacy rules and we may be exposed to reputation damage and loss of customers' trust and business. This could result in costly investigations and litigation, civil or criminal penalties and adverse publicity that could adversely affect our financial condition, results of operations and reputation. Further, if we are unable to comply with the security standards established by banks and the credit card industry, we may be subject to fines, restrictions and expulsion from card acceptance programs, which could adversely affect our retail operations.

Our inability or failure to protect our intellectual property or our infringement of other's intellectual property could have a negative impact on our operating results.

We believe that our trademarks and domain names are valuable assets that are critical to our success. The unauthorized use or other misappropriation of our trademarks or domain names could diminish the value of the Zumiez or Blue Tomato brands, our store concepts, our private label brands or our goodwill and cause a decline in our net sales. Although we have secured or are in the process of securing protection for our trademarks and domain names in a number of countries outside of the U.S., there are certain countries where we do not currently have or where we do not currently intend to apply for protection for certain trademarks or at all. Also, the efforts we have taken to protect our trademarks may not be sufficient or effective. Therefore, we may not be able to prevent other persons from using our trademarks or domain names outside of the U.S., which also could adversely affect our business. We are also subject to the risk that we may infringe on the intellectual property rights of third parties. Any infringement or other intellectual property claim made against us, whether or not it has merit, could be time-consuming, result in costly litigation, cause product delays or require us to pay royalties or license fees. As a result, any such claim could have a material adverse effect on our operating results.

The effects of war or acts of terrorism could adversely affect our business.

Most of our stores are located in shopping malls. Any threat of terrorist attacks or actual terrorist events, particularly in public areas, could lead to lower customer traffic in shopping malls. In addition, local authorities or mall management could close shopping malls in response to security concerns. Mall closures, as well as lower customer traffic due to security concerns, could result in decreased sales. Additionally, the armed conflicts in the Middle East, or the threat, escalation or commencement of war or other armed conflict elsewhere, could significantly diminish consumer spending, and result in decreased sales for us. Decreased sales could have a material adverse effect on our business, financial condition and results of operations.

The outcome of litigation could have a material adverse effect on our business, and may result in substantial costs and could divert management's attention.

We are involved, from time to time, in litigation incidental to our business including complaints filed by investors. This litigation could result in substantial costs, and could divert management's attention and resources, which could harm our business. Risks associated with legal liability are often difficult to assess or quantify, and their existence and magnitude can remain unknown for significant periods of time. There can be no assurance that the actual outcome of pending or future litigation will not have a material adverse effect on our results of operations or financial condition. Additionally, while we maintain director and officer liability insurance for litigation surrounding investor lawsuits, the amount of insurance coverage may not be sufficient to cover a claim and the continued availability of this insurance cannot be assured.

Our operations expose us to the risk of litigation, which could lead to significant potential liability and costs that could harm our business, financial condition or results of operations.

We employ a substantial number of full-time and part-time employees, a majority of whom are employed at our store locations. As a result, we are subject to a large number of federal, state and foreign laws and regulations relating to employment. This creates a risk of potential claims that we have violated laws related to discrimination and harassment, health and safety, wage and hour laws, criminal activity, personal injury and

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other claims. We are also subject to other types of claims in the ordinary course of our business. Some or all of these claims may give rise to litigation, which could be time-consuming for our management team, costly and harmful to our business.

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In addition, we are exposed to the risk of class action litigation. The costs of defense and the risk of loss in connection with class action suits are greater than in single-party litigation claims. Due to the costs of defending against such litigation, the size of judgments that may be awarded against us, and the loss of significant management time devoted to such litigation, we cannot assure you that such litigation will not disrupt our business or impact our financial results.

Our failure to comply with federal, state, local or foreign laws, or changes in these laws, could have an adverse impact on our results of operations and financial performance.

Our business is subject to a wide array of laws and regulations. Changes in the regulations, the imposition of additional regulations, or the enactment of any new legislation including those related to health care, taxes, privacy, environmental issues and trade, could adversely affect our results of operations or financial condition.

Enacted federal health care legislation could increase our expenses.

We are self-insured with respect to our health care coverage in the U.S. and do not purchase third party insurance for the health insurance benefits provided to employees with the exception of pre-defined stop loss coverage, which helps limit the cost of large claims. In March 2010, The Patient Protection and Affordable Care Act was enacted requiring employers such as us to provide health insurance for all qualifying employees or pay penalties for not providing coverage. The most significant increases in cost will occur in fiscal 2014 and fiscal 2015. We are evaluating the impact the new law will have on us, and although we cannot predict with certainty the financial and operational impacts the new law will have, we expect to be required to provide health benefits to more employees than we currently do, which could raise our labor costs. While the majority of these costs will begin in fiscal 2014 and fiscal 2015, there is no assurance that we will be able to absorb and/or pass through the costs of such legislation in a manner that will not adversely impact our results or operations.

We have incurred and will continue to incur significant expenses as a result of being a public company, which will negatively impact our financial performance.

We completed our initial public offering in May 2005 and we have incurred and could continue to incur significant legal, accounting, insurance and other expenses as a result of being a public company. Rules and regulations implemented by Congress, the SEC and the Nasdaq Global Select Market have required changes in corporate governance practices of public companies. Compliance with these laws could cause us to incur significant costs and expenses, including legal and accounting costs, and could make some compliance activities more time-consuming and negatively impact our financial performance. Additionally, these rules and regulations may make it more expensive for us to obtain director and officer liability insurance. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors or as officers.

Failure to maintain adequate financial and management processes and controls could lead to errors in our financial reporting and could harm our ability to manage our expenses.

Reporting obligations as a public company and our anticipated growth, both domestically and internationally, are likely to place a considerable strain on our financial and management systems, processes and controls, as well as on our personnel. In addition, we are required to document and test our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 so that our management can certify as to the effectiveness of our internal controls and our independent registered public accounting firm can render an opinion on the effectiveness of our internal control over financial reporting on an annual basis. This process requires us to document our internal controls over financial reporting and to potentially make significant changes thereto, if applicable. As a result, we have incurred and expect to continue to incur substantial expenses to test our financial controls and systems, and we have been and in the future may be required to improve our financial and managerial controls, reporting systems and procedures, to incur substantial expenses to make such improvements and to hire additional personnel. If our management is ever unable to certify the effectiveness of our internal controls or if our independent registered public accounting firm cannot render an opinion on the effectiveness of our internal control over financial reporting, or if material weaknesses in our internal controls are ever identified, we could be subject to regulatory scrutiny and a loss of public confidence, which could have a material adverse effect on our business and our stock price. In addition, if we do not maintain adequate financial and management personnel, processes and controls, we may not be able to accurately report our financial performance on a timely basis, which could cause a decline in our stock price and adversely affect our ability to raise capital.

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Changes to accounting rules or regulations could significantly affect our financial results.

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. New accounting rules or regulations and changes to existing accounting rules or regulations have occurred and may occur in the future. Future changes to accounting rules or regulations, such as changes to lease accounting guidance or a requirement to convert to international financial reporting standards, could negatively affect our results of operations and financial condition through increased cost of compliance.

We may fail to meet analyst expectations, which could cause the price of our stock to decline.

Our common stock is traded publicly and various securities analysts follow our financial results and issue reports on us. These reports include information about our historical financial results as well as the analysts' estimates of our future performance. The analysts' estimates are based upon their own independent opinions and can be different from our estimates or expectations. If our operating results are below the estimates or expectations of public market analysts and investors, our stock price could decline. In December 2007, a securities class action litigation and associated derivative lawsuits were brought against us and such actions are frequently brought against other companies following a decline in the market price of their securities. These lawsuits were dismissed with prejudice in March 2009. If our stock price is volatile, we may become involved in this type of litigation in the future. Any litigation could result in substantial costs and a diversion of management's attention and resources that are needed to successfully run our business.

The value of our investments may fluctuate.

We have our excess cash primarily invested in state and local municipal securities, corporate debt securities and variable-rate demand notes. These investments have historically been considered very safe investments with minimal default rates. At August 3, 2013, we had \$77.0 million of investments in state and local government securities and variable-rate demand notes. These securities are not guaranteed by the U.S. government and are subject to additional credit risk based upon each local municipality's tax revenues and financial stability. As a result, we may experience a reduction in value or loss of liquidity of our investments, which may have a negative adverse effect on our results of operations, liquidity and financial condition.

A decline in the market price of our stock and our performance may trigger an impairment of the goodwill and other indefinite-lived intangible assets recorded on the condensed consolidated balance sheets.

Goodwill and other indefinite-lived intangible assets are required to be tested for impairment at least annually or more frequently if management believes indicators of impairment exist. Any reduction in the carrying value of our goodwill or other indefinite-lived intangible assets as a result of our impairment analysis could result in a non-cash impairment charge, which could have a significant impact on earnings.

Reduced operating results and cash flows may cause us to incur impairment charges.

We review the carrying value of our fixed assets for impairment whenever events or changes in circumstances indicate that the carrying value of such asset may not be recoverable. The review could result in a non-cash impairment charge related to underperforming stores, which could impact our results of operations.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

Our market risk profile at August 3, 2013 has not significantly changed since February 2, 2013. Our market risk profile at February 2, 2013 is disclosed in our Annual Report on Form 10-K.

Item 4: Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)). Based on this evaluation, our CEO and CFO concluded that, as of August 3, 2013, our disclosure controls and procedures were effective.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity's disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur

because of human failures such as simple errors or mistakes or intentional circumvention of the established process.

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Changes in Internal Control over Financial Reporting. There has been no change in our internal control over financial reporting (as defined in Securities Exchange Act Rule 13a-15(f)) during the quarter ended August 3, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved from time to time in litigation incidental to our business. We are unable to predict the outcome of litigated cases. A court determination in any of litigation actions against us could result in significant liability and could have a material adverse effect on our business, results of operations or financial condition.

See Note 5 to the Notes to Condensed Consolidated Financial Statements found in Item 1 of this Form 10-Q (listed under *Litigation* under *Commitments and Contingencies*).

Item 1A. Risk Factors

Please refer to the Risk Factors set forth in Item 2 of Part I of this Form 10-Q as well as the risk factors previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended February 2, 2013. There have been no material changes in the risk factors set forth in our Annual Report on Form 10-K for the year ended February 2, 2013.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

We did not repurchase any shares during the thirteen weeks ended August 3, 2013. As of August 3, 2013, the maximum dollar value of shares that may yet be repurchases under our current share repurchase program was \$12.5 million. The share repurchase program is conducted under authorizations made from time to time by our Board of Directors. In November 2012, we publicly announced that our Board of Directors authorized us to repurchase up to \$22.0 million of our common stock. This repurchase program was completed in December 2012. In December 2012, we publicly announced that our Board of Directors authorized us to repurchase up to an additional \$20.0 million of our common stock. The repurchase program is expected to continue through fiscal 2013 that will end on February 1, 2014, unless the time period is extended or shortened by the Board of Directors.

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

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Item 6. Exhibits

Exhibit No.	Description of Exhibits
10.19	Amended Credit Agreement with Wells Fargo Bank, N.A. dated June 14, 2013 (incorporated by reference from Exhibit 10.19 to the Form 8-K filed by the Company on June 19, 2013)
31.1	Certification of the Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications of the Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
101	The following materials from Zumiez Inc.'s Quarterly Report on Form 10-Q for the quarterly period ended August 3, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets at August 3, 2013 and February 2, 2013; (ii) Condensed Consolidated Statements of Income for the three and six months ended August 3, 2013 and July 28, 2012; (iii) Condensed Consolidated Statements of Comprehensive Income for the three and six months ended August 3, 2013 and July 28, 2012; (iv) Condensed Consolidated Statements of Changes in Shareholders' Equity for the six months ended August 3, 2013 and July 28, 2012; (v) Condensed Consolidated Statements of Cash Flows for the six months ended August 3, 2013 and July 28, 2012; and (vi) Notes to Condensed Consolidated Financial Statements.

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SIGNATURE

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

ZUMIEZ INC.

Dated: September 11, 2013

By: /s/ Christopher C. Work
Christopher C. Work
Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)