

Zumiez Inc
Form 10-K
March 14, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended: January 30, 2016

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
Commission File Number: 000-51300

ZUMIEZ INC.

(Exact name of Registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

91-1040022
(IRS Employer
Identification No.)

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4001 204th Street SW
Lynnwood, Washington
(Address of principal executive offices)

(425) 551-1500

98036
(Zip Code)

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: **Common Stock**

Name of each exchange on which registered: **The Nasdaq Global Select Market**

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 last 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

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

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant as of the last business day of the second fiscal quarter, August 1, 2015, was \$523,197,781. At March 7, 2016, there were 25,488,900 shares outstanding of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of this report is incorporated by reference from the Registrant's definitive proxy statement, relating to the Annual Meeting of Shareholders scheduled to be held June 1, 2016, which definitive proxy statement will be filed not later than 120 days after the end of the fiscal year to which this report relates.

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ZUMIEZ INC.

FORM 10-K

PART I.

This Form 10-K contains forward-looking statements. These 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 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 in Item 1A below and in Item 7 of Part II of this Form 10-K. 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.

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 2016 will be the 52 week period ending January 28, 2017. Fiscal 2015 was the 52 week period ending January 30, 2016. Fiscal 2014 was the 52-week period ending January 31, 2015. Fiscal 2013 was the 52-week period ending February 1, 2014. Fiscal 2012 was the 53-week period ending February 2, 2013. Fiscal 2011 was the 52-week period ending January 28, 2012.

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

Item 1. BUSINESS

Zumiez Inc., including its wholly-owned subsidiaries, is a leading specialty retailer of apparel, footwear, accessories and hardgoods for young men and women who want to express their individuality through the fashion, music, art and culture of action sports, streetwear, and other unique lifestyles. Zumiez Inc. was formed in August 1978 and is a Washington State corporation.

At January 30, 2016, we operated 658 stores; 592 in the United States (U.S.), 42 in Canada and 24 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.

We completed the acquisition of Snowboard Dachstein Tauern GmbH and Blue Tomato Graz Handel GmbH (collectively, Blue Tomato) during fiscal 2012. Blue Tomato is one of the leading European specialty retailers of apparel, footwear, accessories and hardgoods.

We employ a sales strategy that integrates our stores with our ecommerce platform. There is significant interaction between our store sales and our ecommerce sales channels and we believe that they are utilized in tandem to serve our customers. Our selling platforms bring the look and feel of an independent specialty shop through a distinctive store environment and high-energy sales personnel. We seek to staff our stores with store associates who are knowledgeable users of our products, which we believe provides our customers with enhanced customer service and supplements our ability to identify and react quickly to emerging trends and fashions. We design our selling platforms to appeal to teenagers and young adults and to serve as a destination for our customers. We believe that our distinctive selling platforms concepts and compelling economics will provide continued opportunities for growth in both new and existing markets.

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We believe that our customers desire authentic merchandise and fashion that is rooted in the fashion, music, art and culture of action sports, streetwear, and other unique lifestyles to express their individuality. We strive to keep our merchandising mix fresh by continuously introducing new brands, styles and categories of product. Our focus on a diverse collection of brands allows us to quickly adjust to changing fashion trends. We believe that our strategic mix of apparel, footwear, accessories and hardgoods, including skateboards, snowboards, bindings, components and other equipment, allows us to strengthen the potential of the brands we sell and helps to affirm our credibility with our customers. In addition, we supplement our merchandise mix with a select offering of private label apparel and products as a value proposition that we believe complements our overall merchandise selection.

Over our 37-year history, we have developed a corporate culture based on a passion for action sports, streetwear and other unique lifestyles. We have increased our store count from 400 as of the end of fiscal 2010 to 658 as of the end of fiscal 2015, representing a compound annual growth rate of 10.5%; increased net sales from \$478.8 million in fiscal 2010 to \$804.2 million in fiscal 2015, representing a compound annual growth rate of 10.9%; and been profitable in every fiscal year of our 37-year history.

Competitive Strengths

We believe that the following competitive strengths differentiate us from our competitors and are critical to our continuing success.

Attractive Lifestyle Retailing Concept. We target a large population of young men and women, many of whom we believe are attracted to action sports, streetwear, and other unique lifestyles and desire to express their personal independence and style through the apparel, footwear and accessories they wear and the equipment they use. We believe we have developed a brand image that our customers view as consistent with their attitudes, fashion tastes and identity that should allow us to benefit and differentiates us in our market.

Differentiated Merchandising Strategy. We have created a highly differentiated retailing concept by offering an extensive selection of current and relevant lifestyle brands encompassing apparel, footwear, accessories and hardgoods. The breadth of merchandise offered through our sales channels exceeds that offered by many of our competitors and includes some brands and products that are available only at our stores within many malls or shopping areas. Many of our customers desire to update their wardrobes and equipment as fashion trends evolve or the season dictates, providing us the opportunity to shift our merchandise selection seasonally. We believe that our ability to quickly recognize changing brand and style preferences and transition our merchandise offerings allows us to continually provide a compelling offering to our customers.

Deep-rooted Culture. We believe our culture and brand image enable us to successfully attract and retain high quality employees who are passionate and knowledgeable about the products we sell. We place great emphasis on customer service and satisfaction, and we have made this a defining feature of our corporate culture. To preserve our culture, we strive to promote from within and we provide our employees with the knowledge and tools to succeed through our comprehensive training programs and the empowerment to manage their stores to meet localized customer demand.

Distinctive Customer Experience. We strive to provide a convenient shopping environment that is appealing and clearly communicates our distinct brand image. We seek to integrate our store and digital shopping experiences to serve our customers whenever, wherever, and however they choose to engage with us. We seek to attract knowledgeable sale associates who identify with our brand and are able to offer superior customer service, advice and product expertise. We believe that our distinctive shopping experience enhances our image as a leading source for apparel and equipment for action sports, streetwear, and other unique lifestyles.

Disciplined Operating Philosophy. We have an experienced senior management team. Our management team has built a strong operating foundation based on sound retail principles that underlie our unique culture. Our

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philosophy emphasizes an integrated combination of results measurement, training and incentive programs, all designed to drive sales productivity to the individual store associate level. Our comprehensive training programs are designed to provide our employees with enhanced product knowledge, selling skills and operational expertise. We believe that our merchandising teams' immersion in the lifestyles we represent, supplemented with feedback from our customers, store associates and omni-channel leadership, allows us to consistently identify and react to emerging fashion trends. We believe that this, combined with our inventory planning and allocation processes and systems, helps us better manage markdown and fashion risk.

High-Impact, Integrated Marketing Approach. We seek to build relationships with our customers through a multi-faceted marketing approach that is designed to integrate our brand images with the lifestyles we represent. Our marketing efforts focus on reaching our customers in their environment and feature extensive grassroots marketing events. Our marketing efforts also incorporate local sporting and music event promotions, advertising in magazines popular with our target market, interactive contest sponsorships that actively involve our customers with our brands and products and various social network channels. Events and activities such as these provide opportunities for our customers to develop a strong identity with our culture and brands. We believe that our immersion in the lifestyles we represent allows us to build credibility with our customers and gather valuable feedback on evolving customer preferences.

Growth Strategy

We intend to expand our presence as a leading specialty retailer of action sports, streetwear, and other unique lifestyles by:

Opening New Store Locations. We believe our brand has appeal that provides store expansion opportunities throughout the U.S., Canada and Europe. During the last three fiscal years, we have opened 172 new stores consisting of 57 stores in fiscal 2015, 56 stores in fiscal 2014 and 59 stores in fiscal 2013. We have successfully opened stores in diverse markets throughout the U.S. and internationally, which we believe demonstrates the portability and growth potential of our concepts. To take advantage of what we believe to be a compelling economic store model, we plan to open approximately 34 new stores in fiscal 2016, including stores in our existing markets and in new markets domestically and internationally. The number of anticipated store openings may increase or decrease due to market conditions and other factors.

Continuing to Generate Sales Growth through Existing Channels. We seek to maximize our comparable sales by continuing to integrate our store and on-line shopping experiences and offering our customers a broad and relevant selection of brands and products.

Enhancing our Brand Awareness through Continued Marketing and Promotion. We believe that a key component of our success is the brand exposure that we receive from our marketing events, promotions and activities that embody the unique lifestyles of our customers. These are designed to assist us in increasing brand awareness in our existing markets and expanding into new markets by strengthening our connection with our target customer base. We believe that our marketing efforts have also been successful in generating and promoting interest in our product offerings. In addition, we use our ecommerce presence to further increase our brand awareness. We plan to continue to expand our integrated marketing efforts by promoting more events and activities in our existing and new markets. We also benefit from branded vendors marketing.

Merchandising and Purchasing

Our goal is to be viewed by our customers as the definitive source of merchandise for their unique lifestyles across all channels in which we operate. We believe that the breadth of merchandise that we offer our customers, which includes apparel, footwear, accessories and hardgoods, exceeds that offered by many other specialty stores at a single location, and makes us a single-stop purchase destination for our target customers.

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We seek to identify fashion trends as they develop and to respond in a timely manner with a relevant product assortment. We strive to keep our merchandising mix fresh by continuously introducing new brands or styles in response to the evolving desires of our customers. Our merchandise mix may vary by region, country, and season, reflecting the preferences and seasons in each market.

We believe that offering an extensive selection of current and relevant brands in sports, fashion, music, and art is integral to our overall success. No single brand that we carry accounted for more than 9.8%, 8.7% and 7.6% of our net sales in fiscal 2015, 2014 and 2013. We believe that our strategic mix of apparel, footwear, accessories and hardgoods allows us to strengthen the potential of the brands we sell and affirms our credibility with our customers.

We believe that our ability to maintain an image consistent with the unique lifestyles of our customers is important to our key vendors. Given our scale and market position, we believe that many of our key vendors view us as an important retail partner. This position helps ensure our ability to procure a relevant product assortment and quickly respond to the changing fashion interests of our customers. Additionally, we believe we are presented with a greater variety of products and styles by some of our vendors, as well as certain specially designed items that we exclusively distribute. We supplement our merchandise assortment with a select offering of private label products across many of our product categories. Our private label products complement the branded products we sell, and some of our private label brands allow us to cater to the more value-oriented customer. For fiscal 2015, 2014 and 2013, our private label merchandise represented 21.0%, 19.9% and 17.7% of our net sales.

We have developed a disciplined approach to buying and a dynamic inventory planning and allocation process to support our merchandise strategy. We utilize a broad vendor base that allows us to shift our merchandise purchases as required to react quickly to changing consumer demands and market conditions. We manage the purchasing and allocation process by reviewing branded merchandise lines from new and existing vendors, identifying emerging fashion trends and selecting branded merchandise styles in quantities, colors and sizes to meet inventory levels established by management. We also coordinate inventory levels in connection with individual stores' sales strength, our promotions and seasonality.

Our merchandising staff remains in tune with the fashion, music, art and culture of action sports, streetwear, and other unique lifestyles by participating in action sports, attending relevant events and concerts, watching related programming and reading relevant publications and social network channels. In order to identify evolving trends and fashion preferences, our staff spends considerable time analyzing sales data, gathering feedback from our stores and customers, shopping in key markets and soliciting input from our vendors.

We source our private label merchandise from primarily foreign manufacturers around the world. We have cultivated our private label sources with a view towards high quality merchandise, production reliability and consistency of fit. We believe that our knowledge of fabric and production costs combined with a flexible sourcing base enables us to source high-quality private label goods at favorable costs.

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Store Locations. At January 30, 2016, we operated 658 stores in the following locations:

United States and Puerto Rico - 592 Stores

Alabama	4	Indiana	10	Nebraska	2	Rhode Island	2
Alaska	3	Iowa	4	New Hampshire	6	South Carolina	4
Arizona	13	Kansas	3	New Jersey	20	South Dakota	2
Arkansas	3	Kentucky	4	New Mexico	5	Tennessee	8
California	89	Louisiana	6	New York	33	Texas	52
Colorado	19	Maine	3	Nevada	9	Utah	14
Connecticut	9	Maryland	11	North Carolina	12	Vermont	1
Delaware	4	Massachusetts	11	North Dakota	3	Virginia	14
Florida	32	Michigan	13	Ohio	11	Washington	25
Georgia	12	Minnesota	11	Oklahoma	6	West Virginia	2
Hawaii	6	Mississippi	1	Oregon	13	Wisconsin	14
Idaho	6	Missouri	7	Pennsylvania	21	Wyoming	2
Illinois	19	Montana	5	Puerto Rico	3		

Canada - 42 Stores

Alberta	6	New Brunswick	1	Saskatoon	2
British Columbia	9	Nova Scotia	2		
Manitoba	2	Ontario	20		

Europe - 24 Stores

Austria	12
Germany	12

The following table shows the number of stores (excluding temporary stores that we operate from time to time for special or seasonal events) opened, acquired and closed in each of our last three fiscal years:

Fiscal Year	Stores		Total Number of Stores End of Year
	Opened	Closed	
2015	57	2	658
2014	56	4	603
2013	59	6	551

Store Design and Environment. We design our stores to create a distinctive and engaging shopping environment that we believe resonates with our customers. Our stores feature an industrial look, dense merchandise displays, lifestyle focused posters and signage and popular music, all of which are consistent with the look and feel of an independent specialty shop. Our stores are designed to encourage our customers to shop for longer periods of time, to interact with each other and our store associates and to visit our stores more frequently. Our stores are constructed and finished to allow us to efficiently shift merchandise displays throughout the year as the season dictates. At January 30, 2016, our stores averaged approximately 2,941 square feet. All references in this Annual Report on Form 10-K to square footage of our stores refers to gross square footage, including retail selling, storage and back-office space. In fiscal 2016, we plan on opening new stores with square footage similar to this average.

Expansion Opportunities and Site Selection. In selecting a location for a new store, we target high-traffic locations with suitable demographics and favorable lease terms. For mall locations, we seek locations near busy areas of the mall such as food courts, movie theaters, game stores and other popular teen and young adult

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retailers. We generally locate our stores in malls in which other teen and young adult-oriented retailers have performed well. We also focus on evaluating the market and mall-specific competitive environment for potential new store locations. We seek to diversify our store locations regionally and by caliber of mall.

Store Management, Operations and Training. We believe that our success is dependent in part on our ability to attract, train, retain and motivate qualified employees at all levels of our organization. We have developed a corporate culture that we believe empowers the individual store managers to make store-level business decisions and consistently rewards their success. We are committed to improving the skills and careers of our workforce and providing advancement opportunities for employees.

We believe we provide our managers with the knowledge and tools to succeed through our comprehensive training programs and the flexibility to manage their stores to meet customer demands. While general guidelines for our merchandise assortments, store layouts and in-store visuals are provided by our home offices, we give our managers substantial discretion to tailor their stores to the individual market and empower them to make store-level business decisions. We design group training programs for our managers to improve both operational expertise and supervisory skills.

Our store associates generally have an interest in the fashion, music, art and culture of the action sports lifestyle and are knowledgeable about our products. Through our training, evaluation and incentive programs, we seek to enhance the productivity of our store associates. These programs are designed to promote a competitive, yet fun, culture that is consistent with the unique lifestyles we seek to promote.

Marketing and Advertising

We seek to reach our target customer audience through a multi-faceted marketing approach that is designed to integrate our brand image with the lifestyles we represent. Our marketing efforts focus on reaching our customers in their environment, and feature extensive grassroots marketing events, which give our customers an opportunity to experience and participate in the lifestyles we offer. Our grassroots marketing events are built around the demographics of our customer base and offer an opportunity for our customers to develop a strong identity with our brands and culture.

We have a customer loyalty program, the Zumiez STASH, which allows members to earn points for purchases or performance of certain activities. The points can be redeemed for a broad range of rewards, including product and experiential rewards. Our marketing efforts also incorporate local sporting and music event promotions, advertising in magazines popular with our target market, interactive contest sponsorships that actively involve our customers with our brands and products, the Zumiez STASH, catalogs and various social network channels. We believe that our immersion in action sports, streetwear, and other unique lifestyles allows us to build credibility with our target audience and gather valuable feedback on evolving customer preferences.

Distribution and Fulfillment

Timely and efficient distribution of merchandise to our stores is an important component of our overall business strategy. Domestically, our distribution center is located in Corona, California. At this facility, merchandise is inspected, allocated to stores and distributed to our stores and customers. Each store is typically shipped merchandise five times a week, providing our stores with a steady flow of new merchandise.

During fiscal 2015, we closed our ecommerce fulfillment center located in Edwardsville, Kansas moving to fully localized fulfillment strategy in which we use our domestic store network to provide fulfillment services for the vast majority of customer purchases.

Internationally, we operate a combined distribution and ecommerce fulfillment center located in Graz, Austria that supports our Blue Tomato ecommerce and store operations in Europe and we operate a distribution center located in Delta, British Columbia, Canada to distribute merchandise to our Canadian stores.

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Management Information Systems

Our management information systems provide integration of store, on-line, merchandising, distribution, financial and human resources functions. The systems include applications related to point-of-sale, inventory management, supply chain, planning, sourcing, merchandising and financial reporting. We continue to invest in technology to align these systems with our business requirements and to support our continuing growth.

Competition

The teenage and young adult retail apparel, hardgoods, footwear and accessories industry is highly competitive. We compete with other retailers for vendors, customers, suitable store locations and qualified store associates and management personnel. In the softgoods market, which includes apparel, footwear and accessories, we currently compete with other teenage and young adult focused retailers. In addition, in the softgoods markets we compete with independent specialty shops, department stores and direct marketers that sell similar lines of merchandise and target customers through catalogs and ecommerce. In the hardgoods markets, which includes skateboards, snowboards, bindings, components and other equipment, we compete directly or indirectly with the following categories of companies: other specialty retailers that compete with us across a significant portion of our merchandising categories, such as local snowboard and skate shops; large-format sporting goods stores and chains and ecommerce retailers.

Competition in our sector is based on, among other things, merchandise offerings, store location, price and the ability to identify with the customer. We believe that our ability to compete favorably with many of our competitors is due to our differentiated merchandising strategy, compelling store environment and deep-rooted culture.

Seasonality

Historically, our operations have been seasonal, with the largest portion of net sales and net income occurring in the third and fourth fiscal quarters, reflecting increased demand during the back-to-school and winter holiday selling seasons. During fiscal 2015, approximately 56% of our net sales occurred in the third and fourth quarters combined, similar to previous years. 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. Our quarterly results of operations may also fluctuate based upon such factors as the timing of certain holiday seasons, the popularity of seasonal merchandise offered, the timing and amount of markdowns, competitive influences and the number and timing of new store openings, remodels and closings.

Trademarks

The Zumiez and Blue Tomato trademarks and certain other trademarks, have been registered, or are the subject of pending trademark applications, with the U.S. Patent and Trademark Office and with the registries of certain foreign countries. We regard our trademarks as valuable and intend to maintain such marks and any related registrations and vigorously protect our trademarks. We also own numerous domain names, which have been registered with the Corporation for Assigned Names and Numbers.

Employees

At January 30, 2016, we employed approximately 2,300 full-time and approximately 4,700 part-time employees globally. However, the number of part-time employees fluctuates depending on our seasonal needs and generally increases during peak selling seasons, particularly the back-to-school and the winter holiday seasons. None of our employees are represented by a labor union and we believe that our relationship with our employees is positive.

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Financial Information about Segments

See Note 17, Segment Reporting, in the Notes to Consolidated Financial Statements found in Part IV Item 15 of this Form 10-K, for information regarding our segments, product categories and certain geographical information.

Available Information

Our principal website address is www.zumiez.com. We make available, free of charge, our proxy statement, annual report to shareholders, annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission (SEC) at <http://ir.zumiez.com>. Information available on our website is not incorporated by reference in, and is not deemed a part of, this Form 10-K. The SEC maintains a website that contains electronic filings by Zumiez and other issuers at www.sec.gov. In addition, the public may read and copy any materials Zumiez files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

Item 1A. RISK FACTORS

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

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

In order to generate customer traffic we depend heavily on locating many of our stores in prominent locations within successful shopping malls. Sales at these stores are derived, in part, from the volume of traffic in those malls. Our stores benefit from the ability of a mall's other tenants to generate consumer traffic in the vicinity of our stores and the continuing popularity of malls as shopping destinations. Our sales volume and mall traffic generally may be adversely affected by, among other things, economic downturns in a particular area, competition from ecommerce retailers, non-mall retailers and other malls, increases in gasoline prices, fluctuations in exchange rates in border or tourism-oriented locations and the closing or decline in popularity of other stores in the malls in which we are located. An uncertain economic outlook could curtail new shopping mall development, decrease shopping mall traffic, reduce the number of hours that shopping mall operators keep their shopping malls open or force them to cease operations entirely. A reduction in mall traffic as a result of these or any other factors could have a material adverse effect on our business, results of operations and financial condition.

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

Customer tastes and fashion trends in our market are volatile and tend to change rapidly. Our success depends on our ability to effectively anticipate, identify and respond to changing fashion tastes and consumer

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

the timing of new store openings and the relative proportion of our new stores to mature stores;

whether we are able to successfully integrate any new stores that we acquire and the presence of any unanticipated liabilities in connection therewith;

fashion trends and changes in consumer preferences;

calendar shifts of holiday or seasonal periods;

changes in our merchandise mix;

timing of promotional events;

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

actions by competitors or mall anchor tenants;

weather conditions;

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

inventory shrinkage beyond our historical average rates.

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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 results of operations 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 manufac