

AMERICAN EAGLE OUTFITTERS INC

Form 10-Q

December 05, 2014

[Table of Contents](#)

**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 November 1, 2014**

**OR**

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

**Commission File Number: 1-33338**

**American Eagle Outfitters, Inc.**

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

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

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

N/A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

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

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

Large accelerated filer  Accelerated filer

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 194,490,669 Common Shares were outstanding at December 1, 2014.

Table of Contents

## AMERICAN EAGLE OUTFITTERS, INC.

## TABLE OF CONTENTS

	<b>Page Number</b>
<u>PART I - FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	3
<u>Consolidated Balance Sheets: November 1, 2014, February 1, 2014 and November 2, 2013</u>	3
<u>Consolidated Statements of Operations and Retained Earnings: 13 weeks and 39 weeks ended November 1, 2014 and November 2, 2013</u>	4
<u>Consolidated Statements of Comprehensive Income: 13 weeks and 39 weeks ended November 1, 2014 and November 2, 2013</u>	5
<u>Consolidated Statements of Cash Flows: 39 weeks ended November 1, 2014 and November 2, 2013</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
<u>Report of Independent Registered Public Accounting Firm</u>	19
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	30
Item 4. <u>Controls and Procedures</u>	30
<u>PART II - OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	N/A
Item 1A. <u>Risk Factors</u>	30
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	30
Item 3. <u>Defaults Upon Senior Securities</u>	N/A
Item 4. <u>Mine Safety Disclosures</u>	N/A
Item 5. <u>Other Information</u>	N/A
Item 6. <u>Exhibits</u>	32

**Table of Contents****PART I- FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS.****AMERICAN EAGLE OUTFITTERS, INC.****CONSOLIDATED BALANCE SHEETS**

<i>(In thousands, except per share amount)</i>	November 1, 2014 (Unaudited)	February 1, 2014	November 2, 2013 (Unaudited)
<b>Assets</b>			
Current assets:			
Cash and cash equivalents	\$ 280,445	\$ 418,933	\$ 354,284
Short-term investments		10,002	2,930
Merchandise inventory	468,628	291,541	518,904
Accounts receivable	55,875	73,882	59,277
Prepaid expenses and other	73,095	88,155	112,078
Deferred income taxes	53,445	45,478	46,510
<b>Total current assets</b>	<b>931,488</b>	<b>927,991</b>	<b>1,093,983</b>
Property and equipment, at cost, net of accumulated depreciation	714,166	632,986	630,086
Intangible assets, at cost, net of accumulated amortization	47,864	49,271	44,427
Goodwill	13,512	13,530	13,792
Non-current deferred income taxes	26,598	24,835	19,086
Other assets	38,444	45,551	38,712
<b>Total assets</b>	<b>\$ 1,772,072</b>	<b>\$ 1,694,164</b>	<b>\$ 1,840,086</b>
<b>Liabilities and Stockholders Equity</b>			
Current liabilities:			
Accounts payable	\$ 309,348	\$ 203,872	\$ 353,228
Accrued compensation and payroll taxes	49,562	23,560	32,522
Accrued rent	77,102	76,397	75,680
Accrued income and other taxes	27,472	5,778	9,002
Unredeemed gift cards and gift certificates	27,712	47,194	24,689
Current portion of deferred lease credits	13,392	13,293	13,954
Other liabilities and accrued expenses	41,893	45,384	29,382
<b>Total current liabilities</b>	<b>546,481</b>	<b>415,478</b>	<b>538,457</b>
Non-current liabilities:			
Deferred lease credits	58,988	59,510	65,004
Non-current accrued income taxes	11,312	16,543	20,777
Other non-current liabilities	35,044	36,455	23,139

Edgar Filing: AMERICAN EAGLE OUTFITTERS INC - Form 10-Q

Total non-current liabilities	105,344	112,508	108,920
Commitments and contingencies			
Stockholders' equity:			
Preferred stock, \$0.01 par value; 5,000 shares authorized; none issued and outstanding			
Common stock, \$0.01 par value; 600,000 shares authorized; 249,566 shares issued; 194,491, 193,149 and 192,787 shares outstanding, respectively	2,496	2,496	2,496
Contributed capital	566,449	573,008	577,108
Accumulated other comprehensive income	10,876	12,157	23,483
Retained earnings	1,506,519	1,569,851	1,587,320
Treasury stock, 55,075, 56,417 and 56,779 shares, respectively	(966,093)	(991,334)	(997,698)
Total stockholders' equity	1,120,247	1,166,178	1,192,709
Total liabilities and stockholders' equity	\$ 1,772,072	\$ 1,694,164	\$ 1,840,086

Refer to Notes to Consolidated Financial Statements

Table of Contents

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Unaudited)

	13 Weeks Ended		39 Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
<i>(In thousands, except per share amounts)</i>				
Total net revenue	\$ 854,290	\$ 857,305	\$ 2,211,014	\$ 2,264,095
Cost of sales, including certain buying, occupancy and warehousing expenses	538,818	558,430	1,432,150	1,456,116
Gross profit	315,472	298,875	778,864	807,979
Selling, general and administrative expenses	204,641	205,725	579,777	574,314
Loss on impairment of assets	33,468	19,316	33,468	19,316
Restructuring charges	17,752		17,752	
Depreciation and amortization expense	36,528	31,998	104,312	97,271
Operating income	23,083	41,836	43,555	117,078
Other income, net	649	520	2,185	987
Income before income taxes	23,732	42,356	45,740	118,065
Provision for income taxes	14,697	17,453	27,027	45,592
Net income	\$ 9,035	\$ 24,903	\$ 18,713	\$ 72,473
Net income per basic share	\$ 0.05	\$ 0.13	\$ 0.10	\$ 0.38
Net income per diluted share	\$ 0.05	\$ 0.13	\$ 0.10	\$ 0.37
Cash dividends per common share	\$ 0.125	\$ 0.125	\$ 0.375	\$ 0.25
Weighted average common shares outstanding - basic	194,573	192,818	194,381	192,753
Weighted average common shares outstanding - diluted	195,221	194,612	194,934	195,021
Retained earnings, beginning	\$ 1,522,856	\$ 1,588,094	\$ 1,569,851	\$ 1,553,058
Net income	9,035	24,903	18,713	72,473
Cash dividends and dividend equivalents	(24,882)	(25,099)	(74,713)	(49,673)
Reissuance of treasury stock	(490)	(578)	(7,332)	11,462
Retained earnings, ending	\$ 1,506,519	\$ 1,587,320	\$ 1,506,519	\$ 1,587,320

Refer to Notes to Consolidated Financial Statements

Table of Contents

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

**(Unaudited)**

<i>(In thousands)</i>	13 Weeks Ended		39 Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Net income	\$ 9,035	\$ 24,903	\$ 18,713	\$ 72,473
Other comprehensive loss:				
Foreign currency translation loss	(5,074)	(914)	(1,281)	(5,814)
Other comprehensive loss:	(5,074)	(914)	(1,281)	(5,814)
Comprehensive income	\$ 3,961	\$ 23,989	\$ 17,432	\$ 66,659

Refer to Notes to Consolidated Financial Statements

Table of Contents

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

<i>(In thousands)</i>	39 Weeks Ended	
	November 1, 2014	November 2, 2013
Operating activities:		
Net income	\$ 18,713	\$ 72,473
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	105,294	98,873
Share-based compensation	12,952	(1,793)
Deferred income taxes	(18,580)	23,470
Foreign currency transaction loss	75	798
Loss on impairment of assets	33,468	19,316
Changes in assets and liabilities:		
Merchandise inventory	(176,182)	(185,474)
Accounts receivable	16,687	(13,060)
Prepaid expenses and other	11,155	(33,867)
Other assets	6,980	(5,403)
Accounts payable	100,441	164,988
Unredeemed gift cards and gift certificates	(19,464)	(21,601)
Deferred lease credits	(389)	6,310
Accrued compensation and payroll taxes	24,925	(33,261)
Accrued income and other taxes	19,898	(18,394)
Accrued liabilities	(1,147)	(151)
Total adjustments	116,113	751
<b>Net cash provided by operating activities</b>	<b>134,826</b>	<b>73,224</b>
Investing activities:		
Capital expenditures for property and equipment	(210,534)	(217,214)
Purchase of assets in acquisition		(20,751)
Acquisition of intangible assets	(1,084)	(1,528)
Purchase of available-for-sale securities		(17,373)
Sale of available-for-sale securities	10,002	125,982
<b>Net cash used for investing activities</b>	<b>(201,616)</b>	<b>(130,884)</b>
Financing activities:		
Payments on capital leases	(3,762)	(1,393)
Repurchase of common stock as part of publicly announced programs		(33,051)
Repurchase of common stock from employees	(7,464)	(23,343)
Net proceeds from stock options exercised	7,086	3,323
Excess tax benefit from share-based payments	742	8,267



Edgar Filing: AMERICAN EAGLE OUTFITTERS INC - Form 10-Q

Cash dividends paid	(72,912)	(48,181)
<b>Net cash used for financing activities</b>	<b>(76,310)</b>	<b>(94,378)</b>
Effect of exchange rates changes on cash	4,612	(2,797)
<b>Net decrease in cash and cash equivalents</b>	<b>(138,488)</b>	<b>(154,835)</b>
Cash and cash equivalents - beginning of period	418,933	509,119
Cash and cash equivalents - end of period	<b>\$ 280,445</b>	<b>\$ 354,284</b>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid during the period for income taxes	\$ 7,623	\$ 60,689
Cash paid during the period for interest	\$ 448	\$ 297

Refer to Notes to Consolidated Financial Statements

---

**Table of Contents**

**AMERICAN EAGLE OUTFITTERS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Interim Financial Statements**

The accompanying Consolidated Financial Statements of American Eagle Outfitters, Inc. (the Company) at November 1, 2014 and November 2, 2013 and for the 13 and 39 week periods ended November 1, 2014 and November 2, 2013 have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Certain notes and other information have been condensed or omitted from the interim Consolidated Financial Statements presented in this Quarterly Report on Form 10-Q. Therefore, these Consolidated Financial Statements should be read in conjunction with the Company's Fiscal 2013 Annual Report. In the opinion of the Company's management, all adjustments (consisting of normal recurring adjustments and those described in the footnotes that follow) considered necessary for a fair presentation have been included. The existence of subsequent events has been evaluated through the filing date of this Quarterly Report on Form 10-Q.

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

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

**2. Summary of Significant Accounting Policies**

***Principles of Consolidation***

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. At November 1, 2014, the Company operated in one reportable segment.

***Fiscal Year***

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

***Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of our contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. On an ongoing basis, our management reviews the Company's estimates based on currently available information. Changes in facts and circumstances may result in

revised estimates.

***Recent Accounting Pronouncements***

In May 2014, the Financial Accounting Standard Board ( FASB ) issued Accounting Standards Update ( ASU ) No. 2014-09, *Revenue from Contracts with Customers* ( ASU 2014-09 ). ASU 2014-09 is a comprehensive new revenue recognition model that expands disclosure requirements and requires a company to recognize revenue to depict the transfer of goods or services to a customer at an amount that reflects the consideration it expects to receive in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. Accordingly, the Company will adopt ASU 2014-09 on January 29, 2017. The Company does not expect a material impact of the adoption of this guidance on the Company's consolidated financial condition, results of operations and cash flows.

## **Table of Contents**

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

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

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

### ***Revenue Recognition***

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

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

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

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

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

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

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

## **Table of Contents**

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

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

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

### ***Other Income, Net***

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

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

The Company evaluates its investments for impairment in accordance with ASC 320, *Investments – Debt and Equity Securities* ( ASC 320 ). ASC 320 provides guidance for determining when an investment is considered impaired, whether impairment is other-than-temporary, and measurement of an impairment loss. An investment is considered impaired if the fair value of the investment is less than its cost. If, after consideration of all available evidence to evaluate the realizable value of its investment, impairment is determined to be other-than-temporary, then an impairment loss is recognized in the Consolidated Statement of Operations equal to the difference between the investment's cost and its fair value. There was no net impairment loss for investment securities recognized in earnings during the 13 and 39 weeks ended November 1, 2014 or November 2, 2013.

### ***Cash and Cash Equivalents, Short-term Investments and Long-term Investments***

The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

As of November 1, 2014, the Company held no short-term or long-term investments.

As of November 2, 2013, short-term investments include treasury bills with a maturity of greater than three months, but less than one year. Long-term investments include term deposits with an original maturity of greater than one year. Long-term investments are recorded within other assets on the Company's Consolidated Balance Sheets.

Unrealized gains and losses on the Company's available-for-sale securities are excluded from earnings and are reported as a separate component of stockholders' equity, within accumulated other comprehensive income, until realized. When available-for-sale securities are sold, the cost of the securities is specifically identified and is used to determine any realized gain or loss.

Refer to Note 3 to the Consolidated Financial Statements for information regarding cash and cash equivalents, short-term and long-term investments.

***Merchandise Inventory***

Merchandise inventory is valued at the lower of average cost or market, utilizing the retail method. Average cost includes merchandise design and sourcing costs and related expenses. The Company records merchandise receipts when both title and risk of loss for the merchandise have transferred to the Company.

The Company reviews its inventory levels to identify slow-moving merchandise and generally uses markdowns to clear merchandise. Additionally, the Company estimates a markdown reserve for future planned permanent markdowns related to current inventory. Markdowns may occur when inventory exceeds customer demand for reasons of style, seasonal adaptation, changes in customer preference, lack of consumer acceptance of fashion items, competition, or if it is determined that the inventory in stock will not sell at its currently ticketed price. Such

**Table of Contents**

markdowns may have a material adverse impact on earnings, depending on the extent and amount of inventory affected. The Company also estimates a shrinkage reserve for the period between the last physical count and the balance sheet date. The estimate for the shrinkage reserve, based on historical results, can be affected by changes in merchandise mix and changes in actual shrinkage trends.

***Income Taxes***

The Company calculates income taxes in accordance with ASC 740, *Income Taxes* ( ASC 740 ), which requires the use of the asset and liability method. Under this method, deferred tax assets and liabilities are recognized based on the difference between the Consolidated Financial Statement carrying amounts of existing assets and liabilities and their respective tax bases as computed pursuant to ASC 740. Deferred tax assets and liabilities are measured using the tax rates, based on certain judgments regarding enacted tax laws and published guidance, in effect in the years when those temporary differences are expected to reverse. A valuation allowance is established against the deferred tax assets when it is more likely than not that some portion or all of the deferred taxes may not be realized. Changes in the Company's level and composition of earnings, tax laws or the deferred tax valuation allowance, as well as the results of tax audits may materially impact the Company's effective income tax rate.

The Company evaluates its income tax positions in accordance with ASC 740, which prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return, including a decision whether to file or not to file in a particular jurisdiction. Under ASC 740, a tax benefit from an uncertain position may be recognized only if it is more likely than not that the position is sustainable based on its technical merits.

The calculation of the deferred tax assets and liabilities, as well as the decision to recognize a tax benefit from an uncertain position and to establish a valuation allowance require management to make estimates and assumptions. The Company believes that its assumptions and estimates are reasonable, although actual results may have a positive or negative material impact on the balances of deferred tax assets and liabilities, valuation allowances or net income.

Refer to Note 10 to the Consolidated Financial Statements for additional information regarding income taxes.

***Property and Equipment***

Property and equipment is recorded on the basis of cost, including costs to prepare the asset for use, with depreciation computed utilizing the straight-line method over the assets' estimated useful lives. The useful lives of our major classes of assets are as follows:

Buildings	25 years
Leasehold improvements	Lesser of 10 years or the term of the lease
Fixtures and equipment	5 years

In accordance with ASC 360, *Property, Plant, and Equipment* ( ASC 360 ), the Company evaluates long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified, for stores that have been open for a period of time sufficient to reach maturity. Impairment losses are recorded on long-lived assets used in operations when events and circumstances indicate that the assets are impaired and the undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. When events such as these occur, the impaired assets are adjusted to their estimated fair value and an impairment loss is recorded.



During the 13 weeks ended November 1, 2014, the Company recorded pre-tax asset impairment charges of \$33.5 million that includes \$25.1 million for the impairment of 79 retail stores recorded as a loss on impairment of assets in the Consolidated Statements of Operations. Based on the Company's evaluation of current and future projected performance, it was determined that these stores would not be able to generate sufficient cash flow over the expected remaining lease term to recover the carrying value of the respective stores' assets. Additionally, the Company recorded \$8.4 million of impairment charges related to corporate assets. Refer to Note 12 to the Consolidated Financial Statements for additional information regarding Restructuring Charges.

During the 13 weeks ended November 2, 2013, the Company announced plans to close its Warrendale, Pennsylvania distribution center and transfer the operations to its new Hazelton, Pennsylvania facility, as the Warrendale facility is not physically or geographically capable of supporting the Company's long-term expansion goals. This announcement resulted in \$19.3 million of pre-tax asset impairments.

## **Table of Contents**

Refer to Note 6 to the Consolidated Financial Statements for additional information regarding property and equipment.

### ***Goodwill***

The Company's goodwill is primarily related to the acquisition of its importing operations, Canadian business and businesses in Hong Kong and China. In accordance with ASC 350, *Intangibles - Goodwill and Other* (ASC 350), the Company evaluates goodwill for possible impairment on at least an annual basis and last performed an annual impairment test as of February 1, 2014. As a result of the Company's annual goodwill impairment test, the Company concluded that its goodwill was not impaired.

### ***Intangible Assets***

Intangible assets are recorded on the basis of cost with amortization computed utilizing the straight-line method over the assets' estimated useful lives. The Company's intangible assets, which primarily include trademark assets, are generally amortized over 15 to 25 years.

The Company evaluates intangible assets for impairment in accordance with ASC 350 when events or circumstances indicate that the carrying value of the asset may not be recoverable. Such an evaluation includes the estimation of undiscounted future cash flows to be generated by those assets. If the sum of the estimated future undiscounted cash flows are less than the carrying amounts of the assets, then the assets are impaired and are adjusted to their estimated fair value. No intangible asset impairment charges were recorded during the 13 and 39 weeks ended November 1, 2014 and November 2, 2013.

Refer to Note 7 to the Consolidated Financial Statements for additional information regarding intangible assets.

### ***Gift Cards***

The value of a gift card is recorded as a current liability upon purchase, and revenue is recognized when the gift card is redeemed for merchandise. The Company estimates gift card breakage and recognizes revenue in proportion to actual gift card redemptions as a component of total net revenue. The Company determines an estimated gift card breakage rate by continuously evaluating historical redemption data and the time when there is a remote likelihood that a gift card will be redeemed. The Company recorded \$1.1 million of revenue related to gift card breakage during the 13 weeks ended November 1, 2014 and November 2, 2013, respectively. During the 39 weeks ended November 1, 2014 and November 2, 2013, the Company recorded \$4.1 million and \$4.3 million, respectively, of revenue related to gift card breakage.

### ***Deferred Lease Credits***

Deferred lease credits represent the unamortized portion of construction allowances received from landlords related to the Company's retail stores. Construction allowances are generally comprised of cash amounts received by the Company from its landlords as part of the negotiated lease terms. The Company records a receivable and a deferred lease credit liability at the lease commencement date (date of initial possession of the store). The deferred lease credit is amortized on a straight-line basis as a reduction of rent expense over the term of the original lease (including the pre-opening build-out period). The receivable is reduced as amounts are received from the landlord.

### ***Co-branded Credit Card and Customer Loyalty Program***

The Company offers a co-branded credit card (the AEO Visa Card ) and a private label credit card (the AEO Credit Card ). These credit cards are issued by a third-party bank (the Bank ), and the Company has no liability to the Bank for bad debt expense, provided that purchases are made in accordance with the Bank s procedures. Once a customer is approved to receive the AEO Visa Card or the AEO Credit Card and the card is activated, the customer is eligible to participate in the credit card rewards program. Customers who make purchases earn discounts in the form of savings certificates when certain purchase levels are reached. Also, AEO Visa Card customers who make purchases at other retailers where the card is accepted earn additional discounts. Savings certificates are valid for 90 days from issuance.

Points earned under the credit card rewards program on purchases are accounted for by analogy to ASC 605-25, *Revenue Recognition, Multiple Element Arrangements* ( ASC 605-25 ). The Company believes that points earned

**Table of Contents**

under its point and loyalty programs represent deliverables in a multiple element arrangement rather than a rebate or refund of cash. Accordingly, the portion of the sales revenue attributed to the award points is deferred and recognized when the award is redeemed or when the points expire. Additionally, credit card reward points earned on non-AE or aerie purchases are accounted for in accordance with ASC 605-25. As the points are earned, a current liability is recorded for the estimated cost of the award, and the impact of adjustments is recorded in cost of sales.

The Company offers its customers the AEREWARDS<sup>sm</sup> loyalty program (the Program). Under the Program, customers accumulate points based on purchase activity and earn rewards by reaching certain point thresholds during three-month earning periods. Rewards earned during these periods are valid through the stated expiration date, which is approximately one month from the mailing date of the reward. These rewards can be redeemed for a discount on a purchase of merchandise. Rewards not redeemed during the one-month redemption period are forfeited. The Company determined that rewards earned using the Program should be accounted for in accordance with ASC 605-25. Accordingly, the portion of the sales revenue attributed to the award credits is deferred and recognized when the awards are redeemed or expire.

**Segment Information**

In accordance with ASC 280, *Segment Reporting* (ASC 280), the Company has identified three operating segments (American Eagle Brand retail stores, aerie retail stores and AEO Direct) that reflect the basis used internally to review performance and allocate resources. All of the operating segments have been aggregated and are presented as one reportable segment, as permitted by ASC 280.

**Reclassification**

Certain reclassifications have been made to the Consolidated Financial Statements for prior periods in order to conform to the current period presentation.

**3. Cash and Cash Equivalents, Short-term Investments and Long-term Investments**

The following table summarizes the fair market values for the Company's cash and marketable securities, which are recorded on the Consolidated Balance Sheets:

<i>(In thousands)</i>	November 1, 2014	February 1, 2014	November 2, 2013
<b>Cash and cash equivalents:</b>			
Cash	\$ 185,212	\$ 330,013	\$ 306,572
Money-market	72,896	25,696	21,849
Treasury bills	22,337	63,224	25,863
<b>Total cash and cash equivalents</b>	<b>\$ 280,445</b>	<b>\$ 418,933</b>	<b>\$ 354,284</b>
<b>Short-term investments:</b>			
Treasury bills	\$	\$ 10,002	\$ 2,930
<b>Total short-term investments</b>	<b>\$</b>	<b>\$ 10,002</b>	<b>\$ 2,930</b>
<b>Long-term investments:</b>			
Term-deposits	\$	\$	\$ 9,588

Total long-term investments	\$	\$	\$	9,588
Total	\$	280,445	\$	428,935
			\$	366,802

Proceeds from the sale of investments were \$10.0 million and \$126.0 million for the 39 weeks ended November 1, 2014 and November 2, 2013, respectively. There were no purchases of investments for the 39 weeks ended November 1, 2014. The purchase of investments was \$17.4 million for the 39 weeks ended November 2, 2013.

There were no unrecognized gains or losses for the Company's available-for-sale securities for the 13 and 39 weeks ended November 1, 2014 or November 2, 2013.

#### 4. Fair Value Measurements

ASC 820, *Fair Value Measurement Disclosures* ( ASC 820 ), defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. Fair value is defined under ASC 820 as the exit price associated with the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date.

**Table of Contents****Financial Instruments**

Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. In addition, ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs (i.e., projections, estimates, interpretations, etc.) that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of November 1, 2014 and November 2, 2013, the Company held certain assets that are required to be measured at fair value on a recurring basis. These include cash equivalents and short-term investments.

In accordance with ASC 820, the following table represents the Company's fair value hierarchy for its financial assets (cash equivalents and investments) measured at fair value on a recurring basis at November 1, 2014 and November 2, 2013:

Fair Value Measurements at November 1, 2014				
<i>(In thousands)</i>	Carrying Amount	Quoted Market	Significant Other	Significant
		Prices in Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
<b>Cash and cash equivalents:</b>				
Cash	\$ 185,212	\$ 185,212	0	0
Money-market	72,896	72,896	0	0
Treasury bills	22,337	22,337	0	0
<b>Total cash and cash equivalents</b>	<b>280,445</b>	<b>280,445</b>	<b>0</b>	<b>0</b>
<b>Total</b>	<b>\$ 280,445</b>	<b>\$ 280,445</b>	<b>0</b>	<b>0</b>

Fair Value Measurements at November 2, 2013				
<i>(In thousands)</i>	Carrying Amount	Quoted	Significant	Significant
		Market Prices in	Other Observable	Unobservable Inputs

Edgar Filing: AMERICAN EAGLE OUTFITTERS INC - Form 10-Q

		Active Markets for Identical Assets (Level 1)	Inputs (Level 2)	(Level 3)
<b>Cash and cash equivalents:</b>				
Cash	\$ 306,572	\$ 306,572	\$	\$
Treasury bills	25,863	25,863		
Money-market	21,849	21,849		
<b>Total cash and cash equivalents</b>	<b>\$ 354,284</b>	<b>\$ 354,284</b>	<b>\$</b>	<b>\$</b>
<b>Short-term investments:</b>				
Treasury bills	\$ 2,930	\$ 2,930	\$	\$
<b>Total short-term investments</b>	<b>\$ 2,930</b>	<b>\$ 2,930</b>	<b>\$</b>	<b>\$</b>
<b>Long-term investments:</b>				
Term-deposits	\$ 9,588	\$ 9,588	\$	\$
<b>Total long-term investments</b>	<b>\$ 9,588</b>	<b>\$ 9,588</b>	<b>\$</b>	<b>\$</b>
<b>Total</b>	<b>\$ 366,802</b>	<b>\$ 366,802</b>	<b>\$</b>	<b>\$</b>

**Table of Contents**

In the event the Company holds Level 3 investments, a discounted cash flow model is used to value those investments. There were no Level 3 investments at November 1, 2014 or November 2, 2013.

**Non-Financial Assets**

The Company's non-financial assets, which include goodwill, intangible assets and property and equipment, are not required to be measured at fair value on a recurring basis. However, if certain triggering events occur, or if an annual impairment test is required, and the Company is required to evaluate the non-financial instrument for impairment, a resulting asset impairment would require that the non-financial asset be recorded at the estimated fair value. As a result of the Company's annual goodwill impairment test performed as of February 1, 2014, the Company concluded that its goodwill was not impaired.

Certain long-lived assets were measured at fair value on a nonrecurring basis using Level 3 inputs as defined in ASC 820. During the 39 weeks ended November 1, 2014 and November 2, 2013, certain long-lived assets related to the Company's retail stores and Warrendale Distribution Center were determined to be unable to recover their respective carrying values and were written down to their fair value, resulting in the loss on impairment of assets charge within the Consolidated Statements of Operations for both periods.

The fair value of these assets were determined by estimating the amount and timing of net future cash flows and discounting them using a risk-adjusted rate of interest. The Company estimates future cash flows based on its experience and knowledge of the market in which the store is located.

**5. Earnings per Share**

The following is a reconciliation between basic and diluted weighted average shares outstanding:

<i>(In thousands)</i>	13 Weeks Ended		39 Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Weighted average common shares outstanding:				
Basic number of common shares outstanding	194,573	192,818	194,381	192,753
Dilutive effect of stock options and non-vested restricted stock	648	1,794	553	2,268
Diluted number of common shares outstanding	195,221	194,612	194,934	195,021

Equity awards to purchase approximately 2.4 million shares of common stock during both the 13 and 39 weeks ended November 1, 2014 and approximately 2.9 million and 1.8 shares of common stock during the 13 weeks and 39 weeks ended November 2, 2013, respectively, were outstanding, but were not included in the computation of weighted average diluted common share amounts as the effect of doing so would be anti-dilutive.

There were no shares and 0.5 million shares for both the 13 and 39 weeks ended November 1, 2014, respectively, and 0.9 and 0.8 million shares for the 13 and 39 weeks ended November 2, 2013, respectively, of restricted stock units that were outstanding but not included in the computation of weighted average diluted common share amounts as the effect of doing so would be anti-dilutive. Additionally, approximately 1.8 and 1.9 million shares of restricted stock units for the 13 and 39 weeks ended November 1, 2014, respectively, were not included in the computation of



weighted average diluted common share amounts because the number of shares ultimately issued is contingent on the Company's performance compared to pre-established annual performance goals.

Refer to Note 9 to the Consolidated Financial Statements for additional information regarding share-based compensation.

## 6. Property and Equipment

Property and equipment consists of the following:

<i>(In thousands)</i>	November 1, 2014	February 1, 2014	November 2, 2013
Property and equipment, at cost	\$ 1,694,803	\$ 1,594,360	\$ 1,602,732
Less: Accumulated depreciation	(980,637)	(961,374)	(972,646)
Property and equipment, net	\$ 714,166	\$ 632,986	\$ 630,086

**Table of Contents****7. Intangible Assets**

Intangible assets consist of the following:

<i>(In thousands)</i>	November 1, 2014	February 1, 2014	November 2, 2013
Trademarks and other intangibles, at cost	\$ 59,205	\$ 58,121	\$ 52,484
Less: Accumulated amortization	(11,341)	(8,850)	(8,057)
<b>Intangible assets, net</b>	<b>\$ 47,864</b>	<b>\$ 49,271</b>	<b>\$ 44,427</b>

**8. Other Credit Arrangements**

On March 2, 2012, the Company entered into a five-year, \$150.0 million syndicated, unsecured, revolving credit agreement (the *Credit Agreement*). The primary purpose of the *Credit Agreement* is to provide additional access to capital for general corporate purposes, growth initiatives and the issuance of letters of credit.

The *Credit Agreement* contains financial covenants that require the Company to maintain certain coverage and leverage ratios, and various customary affirmative and negative covenants such as the ability to incur additional debt not otherwise permitted under the *Credit Agreement*.

The *Credit Agreement* has various borrowing options, including rates of interest that are based on (i) an Adjusted London Interbank Offered Rate ( *LIBOR* as defined in the *Credit Agreement*) plus a margin ranging from 1.00% to 1.75% based on a defined leverage ratio, payable at the end of the applicable interest period; and (ii) a Base Rate (as defined in the *Credit Agreement*), plus a margin ranging from 0.00% to 0.75% based on a defined leverage ratio, payable quarterly.

Under the *Credit Agreement*, the Company is also required to pay a commitment fee ranging from 0.175% to 0.30%, based on the defined leverage ratio, on the unused portion of the total lender commitments.

As of November 1, 2014, the Company was in compliance with the terms of the *Credit Agreement* and had \$8.2 million outstanding in letters of credit and no borrowings.

The *Credit Agreement* replaced uncommitted demand lines in the aggregate amount of \$110.0 million USD and \$25.0 million Canadian Dollar ( *CAD* ).

Additionally, the Company has agreements with two separate financial institutions for an aggregate of \$155.0 million USD for the purposes of trade letter of credit issuances. The availability of any future issuances under the trade letter of credit facilities is subject to acceptance by the respective financial institutions.

As of November 1, 2014, the Company had outstanding trade letters of credit of \$44.6 million.

Refer to Note 13 to the Consolidated Financial Statements for a subsequent event footnote related to the Company's credit facilities.

**9. Share-Based Compensation**

The Company accounts for share-based compensation under the provisions of ASC 718, *Compensation - Stock Compensation* ( ASC 718 ), which requires companies to measure and recognize compensation expense for all share-based payments at fair value. Total share-based compensation expense included in the Consolidated Statements of Operations for the 13 and 39 weeks ended November 1, 2014 was \$6.5 million (\$4.0 million, net of tax) and \$13.0 million (\$8.0 million, net of tax), respectively. Total share-based compensation expense included in the Consolidated Statements of Operations for the 13 and 39 weeks ended November 2, 2013 was a net benefit of \$11.5 million (\$7.1 million, net of tax) and \$1.8 million (\$1.1 million, net of tax), respectively.

### ***Stock Option Grants***

The Company grants both time-based and performance-based stock options. Time-based stock option awards vest over the requisite service period of the award or to an employee's eligible retirement date, if earlier. Performance-based stock option awards vest over one year and are earned if the Company meets pre-established performance goals.

**Table of Contents**

A summary of the Company's stock option activity for the 39 weeks ended November 1, 2014 follows:

	Options (In thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding - February 1, 2014	3,925	\$ 17.65		
Granted	126	\$ 14.50		
Exercised (1)	(595)	\$ 12.01		
Cancelled	(917)	\$ 24.66		
Outstanding - November 1, 2014	2,539	\$ 16.28	2.0	\$ 257
Vested and expected to vest - November 1, 2014	2,527	\$ 16.29	2.0	\$ 257
Exercisable - November 1, 2014 (2)	95	\$ 10.16	2.2	\$ 257

(1) Options exercised during the 39 weeks ended November 1, 2014 had exercise prices ranging from \$8.09 to \$13.12.

(2) Options exercisable represent in-the-money vested options based upon the weighted-average exercise price of vested options compared to the Company's stock price at November 1, 2014.

The weighted-average grant date fair value of stock options granted during the 39 weeks ended November 1, 2014 and November 2, 2013 was \$3.99 and \$4.17, respectively. The aggregate intrinsic value of options exercised during both the 39 weeks ended November 1, 2014 and November 2, 2013 was \$1.3 million.

Cash received from the exercise of stock options was \$7.1 million for the 39 weeks ended November 1, 2014 and \$3.3 million for the 39 weeks ended November 2, 2013. The actual tax benefit realized from stock option exercises totaled \$3.1 million for the 39 weeks ended November 1, 2014 and \$8.2 million for the 39 weeks ended November 2, 2013.

The fair value of stock options was estimated based on the closing market price of the Company's common stock on the date of the grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

Black-Scholes Option Valuation Assumptions	39 Weeks Ended	
	November 1, 2014	November 2, 2013
Risk-free interest rate (1)	1.5%	0.3%
Dividend yield	3.1%	2.0%
Volatility factor (2)	41.2%	34.4%
Weighted-average expected term (3)	4.5 years	2.5 years

Expected forfeiture rate (4)	8.0%	8.0%
------------------------------	------	------

- (1) Based on the U.S. Treasury yield curve in effect at the time of grant with a term consistent with the expected life of our stock options.
- (2) Based on a combination of historical volatility of the Company's common stock and implied volatility.
- (3) Represents the period of time options are expected to be outstanding, based on historical experience.
- (4) Based upon historical experience.

As of November 1, 2014, there was \$0.5 million of unrecognized compensation expense related to non-vested time-based stock option awards that is expected to be recognized over a weighted average period of 2.3 years.

***Restricted Stock Grants***

Time-based restricted stock awards are comprised of time-based restricted stock units. These awards vest over three years. Time-based restricted stock units receive dividend equivalents in the form of additional time-based restricted stock units, which are subject to the same restrictions and forfeiture provisions as the original award.

**Table of Contents**

Performance-based restricted stock awards include performance-based restricted stock units. These awards cliff vest at the end of a three year period based upon the Company's achievement of pre-established goals throughout the term of the award. Performance-based restricted stock units receive dividend equivalents in the form of additional performance-based restricted stock units, which are subject to the same restrictions and forfeiture provisions as the original award.

The grant date fair value of all restricted stock awards is based on the closing market price of the Company's common stock on the date of grant.

A summary of the Company's restricted stock activity is presented in the following tables:

	Time-Based Restricted Stock Units		Performance-Based Restricted Stock Units	
	39 Weeks Ended November 1, 2014		39 Weeks Ended November 1, 2014	
	Weighted-Average Grant Date Fair		Weighted-Average Grant Date Fair	
<i>(Shares in thousands)</i>	Shares	Value	Shares	Value
Nonvested - February 1, 2014	1,155	\$ 20.13	2,395	\$ 16.85
Granted	1,521	14.13	1,341	14.22
Vested	(647)	18.10	(604)	15.33
Cancelled	(457)	16.93	(145)	17.30
Nonvested - November 1, 2014	1,572	\$ 16.09	2,987	\$ 15.96

As of November 1, 2014, there was \$21.6 million of unrecognized compensation expense related to non-vested time-based restricted stock unit awards that is expected to be recognized over a weighted-average period of 2.1 years. Based on current probable performance, there was \$3.2 million of unrecognized compensation expense related to performance-based restricted stock unit awards which will be recognized as achievement of performance goals is probable over a one to three year period.

As of November 1, 2014, the Company had 8.7 million shares available for all equity grants.

**10. Income Taxes**

The provision for income taxes is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for discrete quarterly events. The effective income tax rate based on actual operating results for the 13 weeks ended November 1, 2014 was 61.9% compared to 41.2% for the 13 weeks ended November 2, 2013. The effective income tax rate based on actual operating results for the 39 weeks ended November 1, 2014 was 59.1% compared to 38.6% for the 39 weeks ended November 2, 2013. The increase in the effective income tax rate this year is primarily due to valuation allowances on foreign losses and lower income.

The Company records accrued interest and penalties related to unrecognized tax benefits in income tax expense. The Company recognizes income tax liabilities related to unrecognized tax benefits in accordance with ASC 740 and adjusts these liabilities when its judgment changes as the result of the evaluation of new information not previously available. Unrecognized tax benefits did not change significantly during the 13 weeks ended November 1, 2014 and November 2, 2013. Over the next twelve months, the Company believes that it is reasonably possible that unrecognized tax benefits may decrease by approximately \$7.5 million due to settlements, expiration of statute of

limitations or other changes in unrecognized tax benefits.

## **11. Legal Proceedings**

The Company is subject to certain legal proceedings and claims arising out of the conduct of its business. In accordance with ASC 450, *Contingencies* ( ASC 450 ), management records a reserve for estimated losses when the loss is probable and the amount can be reasonably estimated. If a range of possible loss exists and no anticipated loss within the range is more likely than any other anticipated loss, the Company records the accrual at the low end of the range, in accordance with ASC 450. As the Company believes that it has provided adequate reserves, it anticipates that the ultimate outcome of any matter currently pending against the Company will not materially affect the consolidated financial position or results of operations of the Company.

**Table of Contents****12. Restructuring Charges**

During the 13 weeks ended November 1, 2014, the Company undertook restructuring aimed at strengthening the store portfolio and reducing corporate overhead, including severance and office space consolidation. These changes are aimed at driving efficiencies and aligning investments in areas that help fuel the business.

Costs associated with restructuring activities are recorded when incurred. A summary of costs recognized within Restructuring Charges on the Consolidated Income Statement for the 13 weeks ended November 1, 2014 are included in the table as follows.

<i>(In thousands)</i>	13 Weeks Ended November 1, 2014
Cash restructuring charges	
Office space consolidation charges	\$ 8,571
Severance and related employee costs	7,816
Other corporate items	1,365
<b>Total restructuring charges</b>	<b>\$ 17,752</b>

The Company also incurred non-cash corporate office and other asset impairment charges of \$8.4 million. This charge is included within Loss on Impairment of Assets on the Consolidated Income Statement. Also included in Loss on Impairment of Assets is \$25.1 million of store asset impairments resulting from evaluation of current and future projected performance.

A rollforward of the liabilities recognized in the Consolidated Balance Sheet is as follows:

<i>(In thousands)</i>	November 1, 2014
Accrued liability as of February 1, 2014	\$
Add: Costs incurred, excluding non-cash charges	17,752
Less: Cash payments	(864)
Accrued liability as of November 1, 2014	\$ 16,888

**13. Subsequent Events**

On December 2, 2014, the Company entered into a new Credit Agreement ( *Credit Agreement* ) for five-year, syndicated, asset-based revolving credit facilities (the *Credit Facilities* ). The Credit Agreement provides senior secured revolving credit for loans and letters of credit up to \$400 million, subject to customary borrowing base limitations. The Credit Facilities provide increased financial flexibility and takes advantage of a favorable credit environment. The Credit Facilities replace the Company's syndicated, unsecured, revolving credit facility in the amount of \$150.0 million.



All obligations under the Credit Facilities are unconditionally guaranteed by certain subsidiaries. The obligations under Credit Agreement are secured by a first-priority security interest in certain working capital assets of the borrowers and guarantors, consisting primarily of cash, receivables, inventory and certain other assets, and will be further secured by first-priority mortgages on certain real property.

The Credit Agreement will mature on December 2, 2019. Stand-by letters of credit totaling approximately \$8.2 million were outstanding under the prior credit facility and are made subject to the Credit Agreement. No loans were outstanding under the Credit Agreement on December 2, 2014.

**Table of Contents**

**Review by Independent Registered Public Accounting Firm**

Ernst & Young LLP, our independent registered public accounting firm, has performed a limited review of the unaudited Consolidated Financial Statements as of and for the thirteen week periods ended November 1, 2014 and November 2, 2013, as indicated in their report on the limited review included below. Since they did not perform an audit, they express no opinion on the unaudited Consolidated Financial Statements referred to above.

**Review Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

American Eagle Outfitters, Inc.

We have reviewed the consolidated balance sheets of American Eagle Outfitters, Inc. (the Company) as of November 1, 2014 and November 2, 2013, and the related consolidated statements of operations and retained earnings, and comprehensive income for the thirteen and thirty-nine week periods ended November 1, 2014 and November 2, 2013 and the consolidated statements of cash flows for the thirty-nine week periods ended November 1, 2014 and November 2, 2013. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of American Eagle Outfitters, Inc. as of February 1, 2014, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the year then ended (not presented herein), and we expressed an unqualified audit opinion on those consolidated financial statements in our report dated March 13, 2014. In our opinion, the accompanying consolidated balance sheet of American Eagle Outfitters, Inc. as of February 1, 2014, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

December 5, 2014

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

The following discussion and analysis of financial condition and results of operations should be read in conjunction with our Fiscal 2013 Management's Discussion and Analysis of Financial Condition and Results of Operations which can be found in our Fiscal 2013 Annual Report on Form 10-K.

In addition, the following discussion and analysis of financial condition and results of operations are based upon our Consolidated Financial Statements and should be read in conjunction with these statements and notes thereto.

This report contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which represent our expectations or beliefs concerning future events, including the following:

the planned opening of approximately 25 AEO stores in the Factory store format in North America and continued international expansion in Mexico, Asia and the United Kingdom during Fiscal 2014;

the success of our efforts to expand internationally, engage in future franchise/license agreements, and/or growth through acquisitions or joint ventures;

the selection of approximately 45 American Eagle Outfitters stores in the United States and Canada for remodeling and refurbishing during Fiscal 2014;

the potential closure of approximately 150 stores in North America through Fiscal 2016;

the planned opening of approximately 40 new international third party operated American Eagle Outfitters stores during Fiscal 2014;

the success of our continued omni-channel transformation and the success of our American Eagle Outfitters and aerie brands within North America and internationally;

the expected payment of a dividend in future periods;

the possibility that our credit facilities may not be available for future borrowings;

the possibility that rising prices of raw materials, labor, energy and other inputs to our manufacturing process, if unmitigated, will have a significant impact to our profitability; and

the possibility that we may be required to take additional store impairment charges related to underperforming stores.

We caution that these forward-looking statements, and those described elsewhere in this report, involve material risks and uncertainties and are subject to change based on factors beyond our control as discussed within Item 1A of this Quarterly Report on Form 10-Q and Item 1A of our Fiscal 2013 Annual Report on Form 10-K. Accordingly, our future performance and financial results may differ materially from those expressed or implied in any such forward-looking statements.

### **Key Performance Indicators**

Our management evaluates the following items, which are considered key performance indicators, in assessing our performance:

*Comparable sales* Comparable sales provide a measure of sales growth for stores and channels open at least one year over the comparable prior year period. In fiscal years following those with 53 weeks, including Fiscal 2013, the prior year period is shifted by one week to compare similar calendar weeks. A store is included in comparable sales in the thirteenth month of operation. However, stores that have a gross square footage increase of 25% or greater due to a remodel are removed from the comparable sales base, but are included in total sales. These stores are returned to the comparable sales base in the thirteenth month following the remodel. Sales from American Eagle Outfitters and aerie stores, as well as sales from AEO Direct, are included in total comparable sales. Sales from franchise stores are not included in comparable sales. Individual American Eagle Outfitters and aerie brand comparable sales disclosures represent sales from stores and AEO Direct.

AEO Direct sales are included in the individual American Eagle Outfitters and aerie brand comparable sales metric for the following reasons:

Our approach to customer engagement is *omni-channel*, which provides a seamless customer experience through both traditional and non-traditional channels, including four wall store locations, web, mobile/tablet devices, social networks, email, in-store displays and kiosks;

Shopping behavior has continued to evolve across multiple channels that work in tandem to meet all customer needs. Management believes that presenting a brand level performance metric that includes all channels (i.e., stores and AEO Direct) to be the most appropriate, given customer behavior; and

## **Table of Contents**

The Company no longer presents AEO Direct separately due to the continued evolution of omni-channel engagement and the reasons discussed above.

Our management considers comparable sales to be an important indicator of our current performance. Comparable sales results are important to achieve leveraging of our costs, including store payroll, store supplies, rent, etc. Comparable sales also have a direct impact on our total net revenue, cash and working capital.

*Gross profit* - Gross profit measures whether we are optimizing the price and inventory levels of our merchandise and achieving an optimal level of sales. Gross profit is the difference between total net revenue and cost of sales. Cost of sales consists of: merchandise costs, including design, sourcing, importing and inbound freight costs, as well as markdowns, shrinkage, certain promotional costs and buying, occupancy and warehousing costs. Design costs consist of: compensation, rent, depreciation, travel, supplies and samples. Buying, occupancy and warehousing costs consist of: compensation, employee benefit expenses and travel for our buyers and certain senior merchandising executives; rent and utilities related to our stores, corporate headquarters, distribution centers and other office space; freight from our distribution centers to the stores; compensation and supplies for our distribution centers, including purchasing, receiving and inspection costs; and shipping and handling costs related to our e-commerce operation. The inability to obtain acceptable levels of sales, 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 income* - Our management views operating income as a key indicator of our success. The key drivers of operating income are comparable sales, gross profit, our ability to control selling, general and administrative expenses, and our level of capital expenditures. Management also uses earnings before interest and taxes as an indicator of successful operating results.

*Return on invested capital* - Our management uses return on invested capital as a key measure to assess our efficiency at allocating capital to profitable investments. This measure is critical in determining which strategic alternatives to pursue.

*Store productivity* - Store productivity, including total net revenue per average square foot, sales per productive hour, average unit retail price ( AUR ), conversion rate, the number of transactions per store, the number of units sold per store and the number of units per transaction, is evaluated by our management in assessing our operational performance.

*Inventory turnover* - Our management evaluates inventory turnover as a measure of how productively inventory is bought and sold. Inventory turnover is important as it can signal slow moving inventory. This can be critical in determining the need to take markdowns on merchandise.

*Cash flow and liquidity* - Our management evaluates cash flow from operations, investing and financing in determining the sufficiency of our cash position. Cash flow from operations has historically been sufficient to cover our uses of cash. Our management believes that cash flow from operations will be sufficient to fund anticipated capital expenditures and working capital requirements.

Our management's goals are to drive improvements to our gross profit performance, bring greater consistency to our results and to deliver profitable growth over the long term.

## **Results of Operations**

### **Overview**

Our third quarter performance was ahead of our expectations and delivered meaningful recovery from the first half of the year. With sales in line with expectations, we effectively controlled expenses and reduced markdowns compared to the same period last year. During the third quarter, we undertook restructuring aimed at strengthening our store portfolio and reducing corporate overhead.

Our third quarter total net revenue was \$854.3 million and consolidated comparable sales, including AEO Direct, decreased 5%, following a 5% decrease last year. By brand, American Eagle Outfitters comparable sales decreased 6% while aerie increased 3%.

Gross profit increased 6% to \$315.5 million compared to \$298.9 million last year and leveraged 200 basis points to 36.9% as a rate to total net revenue. The improvement is largely attributed to improvement in the markdown rate partially offset by deleverage of buying, occupancy and warehousing costs on negative comparable sales.

**Table of Contents**

Operating income for the third quarter was \$23.1 million, which included \$33.5 million of impairment and \$17.8 million of restructuring charges. Net income for the third quarter this year was \$9.0 million, or \$0.05 per diluted share compared to net income of \$24.9 million, or \$0.13 per diluted share for the same period last year. Excluding asset impairment and restructuring charges, adjusted net income per diluted share was \$0.22 for the third quarter this year and \$0.19 for the same period last year.

The following discussion and analysis of financial condition and results of operations contains non-GAAP financial measures ( non-GAAP or adjusted ), comprised of earnings per share information excluding non-GAAP items. This financial measure is not based on any standardized methodology prescribed by U.S. GAAP and is not necessarily comparable to similar measures presented by other companies. We believe that this non-GAAP information is useful as an additional means for investors to evaluate our operating performance, when reviewed in conjunction with our GAAP financial statements. These amounts are not determined in accordance with GAAP and therefore, should not be used exclusively in evaluating our business and operations. The table below reconciles the GAAP financial measure to the non-GAAP financial measure discussed above.

	13 Weeks Ended November 1, 2014	13 Weeks Ended November 2, 2013
Net income per diluted share - GAAP Basis	\$ 0.05	\$ 0.13
Add back: Asset Impairment and Corporate Overhead Reduction Charges <sup>(1)</sup>	\$ 0.17	\$ 0.06
Adjusted net income per diluted share - Non-GAAP Basis	\$ 0.22	\$ 0.19

(1)- Non-GAAP adjustments consist of \$33.5 million of corporate and store asset impairments and \$17.8 million of restructuring charges that include severance and related employee costs and corporate charges this year, compared to \$19.3 million of asset impairments related to the Warrendale Distribution Center last year. We had \$280.4 million in cash and cash equivalents as of November 1, 2014. Merchandise inventory at the end of the third quarter was \$468.6 million, compared to \$518.9 million last year, a decrease of 14% on a cost per foot basis. Inventories reflect a change to ownership terms completed late last year, as we began taking ownership of inventory at the receiving port rather than the port of departure. Excluding the change in terms, inventory at cost per foot decreased in the mid single-digits.

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

**Table of Contents**

The following table shows the percentage relationship to total net revenue of the listed line items included in our Consolidated Statements of Operations.

	13 Weeks Ended		39 Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Total net revenue	100.0%	100.0%	100.0%	100.0%
Cost of sales, including certain buying, occupancy and warehousing expenses	63.1	65.1	64.8	64.3
Gross profit	36.9	34.9	35.2	35.7
Selling, general and administrative expenses	24.0	24.0	26.2	25.4
Restructuring charges	2.1		0.8	
Loss on impairment of assets	3.9	2.3	1.5	0.8
Depreciation and amortization expense	4.2	3.8	4.7	4.3
Operating income	2.7	4.8	2.0	5.2
Other income, net	0.1	0.1	0.1	0.0
Income before income taxes	2.8	4.9	2.1	5.2
Provision for income taxes	1.7	2.0	1.2	2.0
Net income	1.1%	2.9%	0.9%	3.2%

The following table shows our adjusted consolidated store data:

	13 Weeks Ended		39 Weeks Ended	
	November 1, 2014	November 2, 2013	November 1, 2014	November 2, 2013
Number of stores:				
Beginning of period	1,072	1,056	1,066	1,044
Opened (1)	23	13	54	46
Closed	(3)	(5)	(28)	(26)
End of period	1,092	1,064	1,092	1,064
Total gross square feet at end of period	6,796,073	6,455,497	6,796,073	6,455,497
International licensed/franchise stores at end of period (2)	94	61	94	61



- (1) Store openings for the 39 weeks ended November 1, 2014 include 10 stores in Mexico, seven stores in Canada, four stores in China and two in Hong Kong.
- (2) International licensed/franchise stores are not included in the consolidated store data or the total gross square feet calculation.

Our operations are conducted in one reportable segment, which includes 988 American Eagle Outfitters retail stores, 104 aerie stand-alone retail stores and AEO Direct.

### **Comparison of the 13 weeks ended November 1, 2014 to the 13 weeks ended November 2, 2013**

#### *Total Net Revenue*

Total net revenue was \$854.3 million, a slight decrease as compared to \$857.3 million last year. Revenue from new store growth nearly offset the 5% decline in total comparable sales. By brand, including the respective AEO Direct sales, American Eagle Outfitters brand comparable sales decreased 6%, or \$41.2 million, and aerie brand comparable sales increased 3%, or \$1.4 million.

Total comparable sales for AE women's and men's decreased 4% and 7%, respectively. On a consolidated basis, the number of transactions declined. However, as a result of reduced markdowns and a change in promotional strategies, the average transaction value increased in the high single-digits, driven by mid single-digit increases in both the average unit retail and units per transaction.

## **Table of Contents**

### *Gross Profit*

Gross profit increased 6% to \$315.5 million compared to \$298.9 million last year. As a rate to total net revenue, gross profit was 36.9% compared to 34.9% in the same quarter last year. Favorable product costs provided 40 basis points of improvement combined with 280 basis points of total markdown expense improvement. Additionally, buying, occupancy and warehousing costs increased 120 basis points as a rate to total net revenue from rent on negative comparable sales and increased delivery costs.

There was \$3.9 million of share-based payment expense included in gross profit for the period ended November 1, 2014 comprised of both time and performance-based awards. This is compared to a net benefit of \$7.5 million of share-based payment expense included in gross profit for the period ended November 2, 2013.

Our gross profit may not be comparable to that of other retailers, as some retailers include all costs related to their distribution network as well as design costs in cost of sales and others may exclude a portion of these costs from cost of sales, including them in a line item such as selling, general and administrative expenses. Refer to Note 2 to the Consolidated Financial Statements for a description of our accounting policy regarding cost of sales, including certain buying, occupancy and warehousing expenses.

### *Selling, General and Administrative Expenses*

Selling, general and administrative ( SG&A ) expenses decreased 1% to \$204.6 million from \$205.7 million last year. As a rate to total net revenue, SG&A expenses remained flat at 24.0%. The dollar decrease this year is a result of reduced overhead and variable expense, partially offset by continued investments in advertising and international expansion, as well as increased incentive expense accruals.

There was \$2.6 million of share-based payment expense included in SG&A expenses for the period ended November 1, 2014 comprised of both time and performance-based awards. This is compared to a net benefit of \$4.0 million of share-based payment expense included in selling, general and administrative expenses for the period ended November 2, 2013.

### *Restructuring Charges*

Restructuring charges were \$17.8 million, or 2.1% as a rate to total net revenue, for the 13 weeks ended November 1, 2014. This amount consists of corporate overhead reductions, including severance and related items, and office space consolidation.

The restructuring charges are aimed at strengthening our corporate assets. Corporate overhead expenses eliminated redundancies at the home office. These changes are aimed at driving efficiencies and aligning investments in areas that help fuel the business.

### *Loss on Impairment of Assets*

Loss on impairment of assets was \$33.5 million this year as compared to \$19.3 million last year. The impairment loss this year, as a result of store fleet and corporate location review and challenging performance this year, consisted of \$25.1 million for the impairment of 48 AE and 31 aerie stores and \$8.4 million for corporate items. Last year, impairment loss resulted from the plan to close the Warrendale, Pennsylvania distribution center.

### *Depreciation and Amortization Expense*

Depreciation and amortization expense increased to \$36.5 million, compared to \$32.0 million last year. As a rate to total net revenue, depreciation and amortization expense was 4.2% this year as compared to 3.8% last year. The increase was driven by omni-channel and technology investments, new factory and international stores, and the new fulfillment center.

*Other Income, Net*

Other income was \$0.6 million, compared to \$0.5 million last year. The change resulted primarily from foreign currency fluctuations.

## **Table of Contents**

### *Provision for Income Taxes*

The provision for income taxes is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for quarterly events. The effective income tax rate based on actual operating results for the 13 weeks ended November 1, 2014 was 61.9% compared to 41.2% for the 13 weeks ended November 2, 2013. The increase in the effective income tax rate this year is primarily due to valuation allowances on foreign losses and lower earnings.

### *Net Income*

Net income decreased to \$9.0 million, or 1.2% as a percent to total net revenue, from \$24.6 million, or 2.9% as a percent to total net revenue last year. Net income per diluted share decreased to \$0.05 per diluted share from \$0.13 per diluted share in the prior year. The change in net income is attributable to the factors noted above, including the loss on impairment of assets and restructurings charges of \$0.17 per diluted share this year and the loss on impairment of assets of \$0.06 per diluted share last year.

## **Comparison of the 39 weeks ended November 1, 2014 to the 39 weeks ended November 2, 2013**

### *Total Net Revenue*

Total net revenue decreased 2% to \$2.211 billion compared to \$2.264 billion last year. The change in total net revenue resulted primarily from a comparable sales decrease of 7% for the period. By brand, including the respective AEO Direct sales, American Eagle Outfitters brand comparable sales decreased 8%, or \$154.0 million, and aerie brand comparable sales increased 3%, or \$3.5 million.

AE women's and men's comparable sales decreased 6% and 10%, respectively. For the 39 week period, traffic, transactions and average transaction value decreased.

### *Gross Profit*

Gross profit decreased 4% to \$778.9 million compared to \$808.0 million. As a rate to total net revenue, gross profit was 35.2%, compared to 35.8% last year. Favorable product costs provided 100 basis points of improvement. Buying, occupancy and warehousing costs deleveraged 160 basis points from higher delivery costs and deleverage of rent on negative comparable sales.

There was \$6.8 million of share-based payment expense included in gross profit for the period ended November 1, 2014 comprised of both time and performance-based awards. This is compared to a net benefit of \$3.5 million share-based payment expense included in gross profit for the period ended November 2, 2013.

Our gross profit may not be comparable to that of other retailers, as some retailers include all costs related to their distribution network as well as design costs in cost of sales and others may exclude a portion of these costs from cost of sales, including them in a line item such as selling, general and administrative expenses. Refer to Note 2 to the Consolidated Financial Statements for a description of our accounting policy regarding cost of sales, including certain buying, occupancy and warehousing expenses.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased to \$579.8 million from \$574.3 million last year and increased 90 basis points, as a rate to total net revenue, to 26.2% from 25.3% last year. Corporate charges of \$1.5 million were

included in selling, general and administrative expense last year. The dollar increase this year was driven primarily by investments in international growth, factory stores and omni-channel initiatives and increased incentive compensation accruals.

There was \$6.3 million of share-based payment expense included in SG&A expenses for the period ended November 1, 2014 comprised of both time and performance-based awards. This is compared to a net benefit of \$1.6 million of share-based payment expense included in selling, general and administrative expenses for the period ended November 2, 2013.

## **Table of Contents**

### *Restructuring Charges*

Restructuring charges were \$17.8 million, or 0.8% as a rate to total net revenue, for the 39 weeks ended November 1, 2014. This amount consists of corporate overhead reductions, including severance and related items, and office space consolidation.

The restructuring charges are aimed at strengthening our corporate assets. Corporate overhead expenses eliminated redundancies at the home office. These changes are aimed at driving efficiencies and aligning investments in areas that help fuel the business.

### *Loss on Impairment of Assets*

Loss on impairment of assets was \$33.5 million this year as compared to \$19.3 million last year. The impairment loss this year, as a result of store fleet and corporate location review and challenging performance this year, consisted of \$25.1 million for the impairment of 48 AE and 31 aerie stores and \$8.4 million for corporate items. Last year, impairment loss resulted from the plan to close the Warrendale, Pennsylvania distribution center.

### *Depreciation and Amortization Expense*

Depreciation and amortization expense increased to \$104.3 million, compared to \$97.3 million last year. Included in depreciation and amortization were \$7.6 million of asset write-offs last year. As a rate to total net revenue, depreciation and amortization expense was 4.7% this year as compared to 4.3% last year. The increase was driven by omni-channel and technology investments, new factory and international stores, and the new Hazelton, PA distribution and fulfillment center.

### *Other Income, Net*

Other income was \$2.2 million this year, compared to \$1.0 million last year. The change resulted primarily from foreign currency fluctuations.

### *Provision for Income Taxes*

The provision for income taxes is based on the current estimate of the annual effective income tax rate and is adjusted as necessary for discrete quarterly events. The effective income tax rate based on actual operating results for the 39 weeks ended November 1, 2014 was 59.1% compared to 38.6% for the 39 weeks ended November 2, 2013. The increase in the effective income tax rate this year is primarily due to valuation allowances on foreign losses and lower earnings.

### *Net Income*

Net income decreased to \$18.7 million, or 0.9% as a percent to total net revenue, from \$72.5 million, or 3.2% as a percent to total net revenue last year. Net income per diluted share decreased to \$0.10 from \$0.37 in the prior year. The change in net income is attributable to the factors noted above, including the loss on impairment of assets and restructurings charges of \$0.17 per diluted share this year and the loss on impairment of assets of \$0.06 per diluted share last year.

## **International Operations**

We have agreements with multiple third party operators to expand our brands internationally. Through these agreements, a series of franchised, licensed or other brand-dedicated American Eagle Outfitters stores have opened and will continue to open in areas including Eastern Europe, the Middle East, Central and South America, Northern Africa and parts of Asia. These agreements do not involve a significant capital investment or operational involvement from the Company. We continue to increase the number of countries in which we enter into these types of arrangements as part of our strategy to expand internationally. As of November 1, 2014, we had 94 stores operated by our third party operators in 14 countries. International third party operated stores are not included in the consolidated store data or the total gross square feet calculation.

As of November 1, 2014, we had 102 company-operated stores in Canada, 16 in Mexico, five in Hong Kong, eight in China and six in Puerto Rico. We continue to evaluate further opportunities to expand internationally, which may include additional company-operated stores in Mexico, Asia and the United Kingdom as well as stores operated by third party operators under license, franchise and/or joint venture agreements.

**Table of Contents****Fair Value Measurements**

ASC 820 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. Fair value is defined under ASC 820 as the exit price associated with the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date.

**Financial Instruments**

Valuation techniques used to measure fair value under ASC 820 must maximize the use of observable inputs and minimize the use of unobservable inputs. In addition, ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs (i.e., projections, estimates, interpretations, etc.) that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

As of November 1, 2014, we held certain assets that are required to be measured at fair value on a recurring basis. These include cash equivalents.

In accordance with ASC 820, the following table represents the fair value hierarchy of our financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of November 1, 2014:

	Fair Value Measurements at November 1, 2014			
	Carrying Amount	Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>(In thousands)</i>				
Cash and cash equivalents:				
Cash	\$ 185,212	\$ 185,212	0	0
Money-market	72,896	72,896	0	0
Treasury bills	22,337	22,337	0	0
<b>Total cash and cash equivalents</b>	<b>280,445</b>	<b>280,445</b>	<b>0</b>	<b>0</b>
<b>Total</b>	<b>\$ 280,445</b>	<b>\$ 280,445</b>	<b>0</b>	<b>0</b>



Percent to Total	100.0%	100.0%	0.0%	0.0%
------------------	--------	--------	------	------

Refer to Notes 3 and 4 to the Consolidated Financial Statements for additional information on our investment securities, including a description of the securities and a discussion of the uncertainties relating to their liquidity.

### **Liquidity and Capital Resources**

Our uses of cash are generally for working capital, the construction of new stores and remodeling of existing stores, information technology upgrades, distribution center improvements and expansion, the purchase of short-term investments and the return of value to shareholders through the repurchase of common stock and the payment of dividends. Historically, these uses of cash have been funded with cash flow from operations and existing cash on hand. Additionally, our uses of cash include the development of the aerie brand and our international expansion efforts. We expect to be able to fund our future cash requirements in North America through current cash holdings as well as cash generated from operations. In the future, we expect that our uses of cash will also include further expansion of our brands internationally.

**Table of Contents**

Our growth strategy includes fortifying our brands and the further international expansion or acquisitions. We periodically consider and evaluate these options to support future growth. In the event we do pursue such options, we could require additional equity or debt financing. There can be no assurance that we would be successful in closing any potential transaction, or that any endeavor we undertake would increase our profitability.

The following sets forth certain measures of our liquidity:

	November 1, 2014	February 1, 2014	November 2, 2013
Working Capital (in thousands)	\$ 385,007	\$ 512,513	\$ 555,526
Current Ratio	1.70	2.23	2.03

The \$123.1 million decrease in working capital compared to February 1, 2014 and the \$170.5 million decrease compared to last year is primarily related to use of cash for financing and investing activities including capital expenditures and the distribution of cash to shareholders through the payment of dividends.

*Cash Flows from Operating Activities*

Net cash provided by operating activities totaled \$134.8 million and \$73.2 million for the 39 weeks ended November 1, 2014 and November 2, 2013, respectively. For both periods, our major source of cash from operations was merchandise sales and our primary outflow of cash for operations was for the payment of operational costs. The year-over-year increase in cash flows from operations this year was primarily driven by the impact of the change in inventory ownership point and incentive pay-outs, partially offset by decreased income as a result of the 2% decrease in total net revenue.

*Cash Flows from Investing Activities*

Investing activities for the 39 weeks ended November 1, 2014 primarily consisted of \$210.5 million of capital expenditures for property and equipment partially offset by \$10.0 million of proceeds from the sale of investments classified as available-for-sale. Investing activities for the 39 weeks ended November 2, 2013 included \$217.2 million of capital expenditures for property and equipment, \$20.8 million for the purchase of long-lived assets in acquisitions, \$17.4 million of investment security purchases and \$1.5 million for the acquisition of intangibles partially offset by \$126.0 million of proceeds from the sale of investments classified as available-for-sale. Purchase of long-lived assets in acquisition relate to the franchise stores and related assets we acquired from Dickson Concepts (International) Limited.

*Cash Flows from Financing Activities*

Cash used for financing activities for the 39 weeks ended November 1, 2014 consisted primarily of \$72.9 million for cash dividends paid at a quarterly rate of \$0.125 per share, \$7.5 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payment and \$3.8 million for the payments on capital leases, partially offset by \$7.1 million of net proceeds from stock option exercises. There were no purchases of common stock from publically announced programs this year.

Cash used for financing activities for the 39 weeks ended November 2, 2013 consisted primarily of \$48.2 million for cash dividends paid at a quarterly rate of \$0.125 per share in only the second and third quarters of Fiscal 2013, \$33.1 million for the repurchase of common stock as part of publicly announced programs and \$23.3 million for the

repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payment.

*Credit Facilities*

On March 2, 2012, we entered into a five-year, \$150.0 million syndicated, unsecured, revolving credit agreement (the Credit Agreement ). The primary purpose of the Credit Agreement is to provide additional access to capital for general corporate purposes, growth initiatives and the issuance of letters of credit.

The Credit Agreement contains financial covenants that require us to maintain certain coverage and leverage ratios, and various customary affirmative and negative covenants such as the ability to incur additional debt not otherwise permitted under the Credit Agreement.

The Credit Agreement has various borrowing options, including rates of interest that are based on (i) an Adjusted London Interbank Offered Rate ( LIBOR as defined in the Credit Agreement) plus a margin ranging from 1.00% to 1.75% based on a defined leverage ratio, payable at the end of the applicable interest period; and (ii) a Base Rate (as defined in the Credit Agreement), plus a margin ranging from 0.00% to 0.75% based on a defined leverage ratio, payable quarterly.

## **Table of Contents**

Under the Credit Agreement, we are also required to pay a commitment fee ranging from 0.175% to 0.30%, based on the defined leverage ratio, on the unused portion of the total lender commitments.

As of November 1, 2014, we are in compliance with the terms of the Credit Agreement and had \$8.2 million outstanding in letters of credit and no borrowings.

The Credit Agreement replaced uncommitted demand lines in the aggregate amount of \$110.0 million USD and \$25.0 million CAD.

Additionally, we have agreements with two separate financial institutions for an aggregate of \$155.0 million USD for the purposes of trade letter of credit issuances. The availability of any future issuances under the trade letter of credit facilities is subject to acceptance by the respective financial institutions.

As of November 1, 2014, we had outstanding trade letters of credit of \$44.6 million.

Refer to Note 13 to the Consolidated Financial Statements for a subsequent event footnote related to the Company's credit facilities.

### *Capital Expenditures for Property and Equipment*

Capital expenditures for the 39 weeks ended November 1, 2014 were \$210.5 million and included \$85.1 million related to investments in our stores, including 29 new AE stores, 25 new Factory stores and 40 remodels. Additionally, we continued to support our infrastructure growth by investing in information technology initiatives (\$29.9 million), other home office projects (\$11.8 million), the improvement and expansion of our distribution centers (\$69.5 million) and investments in e-commerce (\$14.2 million).

For Fiscal 2014, we expect capital expenditures to be approximately \$230 million related to the continued construction of our new distribution center to support our expansion efforts, stores, information technology upgrades to support growth and investments in e-commerce. New store growth is primarily related to AEO Factory stores, which are among our most productive format, and new wholly-owned international locations in Mexico, Asia and the United Kingdom. Additionally, we plan to remodel and refurbish approximately 45 AEO stores. For Fiscal 2015, we expect capital expenditures to be approximately \$150 million.

### *Stock Repurchases*

During the 39 weeks ended November 1, 2014, there were no share repurchases as a part of our publicly announced repurchase programs. During the 39 weeks ended November 2, 2013, as part of our publicly announced share repurchase program, we repurchased 1.6 million shares for approximately \$33.1 million, at a weighted average price of \$20.66 per share.

During the 39 weeks ended November 1, 2014 and November 2, 2013, we repurchased approximately 0.5 million and 1.1 million shares, respectively, from certain employees at market prices totaling \$7.5 million and \$23.3 million, respectively. These shares were repurchased for the payment of taxes, not in excess of the minimum statutory withholding requirements, in connection with the vesting of share-based payments, as permitted under the Company's equity incentive plans. The aforementioned shares repurchased have been recorded as treasury stock.

### *Dividends*

During the 13 weeks ended November 1, 2014, our Board declared a quarterly cash dividend of \$0.125 per share, which was paid on October 15, 2014. The payment of future dividends is at the discretion of our Board and is based on future earnings, cash flow, financial condition, capital requirements, changes in U.S. taxation and other relevant factors. It is anticipated that any future dividends paid will be declared on a quarterly basis.

### **Critical Accounting Policies**

Our critical accounting policies are described in Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and in the notes to our Consolidated Financial Statements for the year ended February 1, 2014 contained in our Fiscal 2013 Annual Report on Form 10-K. Any new accounting policies or updates to existing accounting policies as a result of new accounting pronouncements have been discussed in the notes to our Consolidated Financial Statements in this Quarterly Report on Form 10-Q. The application of our critical accounting policies may require our management to make judgments and estimates about the amounts reflected in the Consolidated Financial Statements. Our management uses historical experience and all available information to make these estimates and judgments, and different amounts could be reported using different assumptions and estimates.

**Table of Contents**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

There were no material changes in our exposure to market risk from February 1, 2014. Our market risk profile as of February 1, 2014 is disclosed in Item 7A, *Quantitative and Qualitative Disclosures About Market Risk*, of our Fiscal 2013 Annual Report on Form 10-K.

**ITEM 4. CONTROLS AND PROCEDURES.**

*Disclosure Controls and Procedures*

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management including our Principal Executive Officer and our Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

In connection with the preparation of this Quarterly Report on Form 10-Q, as of November 1, 2014, an evaluation was performed under the supervision and with the participation of our management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon that evaluation, our Principal Executive Officer and our Principal Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this Quarterly Report on Form 10-Q.

*Changes in Internal Control over Financial Reporting*

There were no changes in our internal control over financial reporting that occurred during the 13 weeks ended November 1, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1A. RISKFACTORS.**

Risk factors that affect our business and financial results are discussed within Item 1A of our Fiscal 2013 Annual Report on Form 10-K. There have been no material changes to the disclosures relating to this item from those set forth in our Fiscal 2013 Annual Report on Form 10-K.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

**Issuer Purchases of Equity Securities**

The following table provides information regarding our repurchases of our common stock during the 13 weeks ended November 1, 2014.



**Table of Contents**

Period	Total Number of Shares Purchased as		Maximum Number of Shares that May Yet Be Purchased Under the Program	
	Total Number of Shares Purchased	Average Price Paid Per Share	Part of Publicly Announced Programs	Yet Be Purchased Under the Program
	(1)	(2)	(1)	(1) (3)
Month #1 (August 3, 2014 through August 30, 2014)		\$		18,400,000
Month #2 (August 31, 2014 through October 4, 2014)	5,435	\$ 13.74		18,400,000
Month #3 (October 5, 2014 through November 1, 2014)	114	\$ 14.47		18,400,000
<b>Total</b>	<b>5,549</b>	<b>\$ 13.75</b>		<b>18,400,000</b>

- (1) There were no shares repurchased as part of our publicly announced share repurchase program during the 13 weeks ended November 1, 2014, and there were 5,549 shares repurchased for the payment of taxes in connection with the vesting of share-based payments.
- (2) Average price paid per share excludes any broker commissions paid.
- (3) In January 2013, our Board authorized the repurchase of 20.0 million shares of our common stock. The authorization of the remaining 18.4 million shares that may yet be purchased expires on January 28, 2017.



**Table of Contents**

**ITEM 6. EXHIBITS.**

* Exhibit 15	Acknowledgement of Independent Registered Public Accounting Firm
* Exhibit 31.1	Certification by Jay L. Schottenstein pursuant to Rule 13a-14(a) or Rule 15d-14(a)
* Exhibit 31.2	Certification by Mary M. Boland pursuant to Rule 13a-14(a) or Rule 15d-14(a)
**Exhibit 32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
**Exhibit 32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
* Exhibit 101	Interactive Data File

\* Filed with this report.

\*\* Furnished with this report.

**Table of Contents**

**SIGNATURES**

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

Dated: December 5, 2014

American Eagle Outfitters, Inc.

(Registrant)

By: /s/ Jay L. Schottenstein  
Jay L. Schottenstein  
Interim Chief Executive Officer  
(Principal Executive Officer)

By: /s/ Mary M. Boland  
Mary M. Boland  
Chief Financial Officer and Chief Administrative Officer  
(Principal Financial Officer)