

AMERICAN EAGLE OUTFITTERS INC  
Form 10-Q  
May 25, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended April 30, 2016

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)

Delaware (State or other jurisdiction of incorporation or organization)	No. 13-2721761 (I.R.S. Employer Identification No.)
77 Hot Metal Street, Pittsburgh, PA (Address of principal executive offices)	15203-2329 (Zip Code)

Registrant's telephone number, including area code: (412) 432-3300

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

N/A

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

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: 180,894,777 Common Shares were outstanding at May 20, 2016.

AMERICAN EAGLE OUTFITTERS, INC.

## TABLE OF CONTENTS

	Page Number
<b><u>PART I - FINANCIAL INFORMATION</u></b>	
Item 1. <b><u>Financial Statements</u></b>	3
<u>Consolidated Balance Sheets: April 30, 2016 , January 30, 2016 and May 2, 2015</u>	3
<u>Consolidated Statements of Operations and Retained Earnings: 13 weeks ended April 30, 2016 and May 2, 2015</u>	4
<u>Consolidated Statements of Comprehensive Income: 13 weeks ended April 30, 2016 and May 2, 2015</u>	5
<u>Consolidated Statements of Cash Flows: 13 weeks ended April 30, 2016 and May 2, 2015</u>	6
<u>Notes to Consolidated Financial Statements</u>	7
<u>Report of Independent Registered Public Accounting Firm</u>	17
Item 2. <b><u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u></b>	18
Item 3. <b><u>Quantitative and Qualitative Disclosures about Market Risk</u></b>	25
Item 4. <b><u>Controls and Procedures</u></b>	25
<b><u>PART II - OTHER INFORMATION</u></b>	
Item 1. Legal Proceedings	N/A
Item 1A. <b><u>Risk Factors</u></b>	26
Item 2. <b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	26
Item 3. Defaults Upon Senior Securities	N/A
Item 4. Mine Safety Disclosures	N/A
Item 5. Other Information	N/A
Item 6. <b><u>Exhibits</u></b>	27

## PART I - FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)	April 30, 2016 (Unaudited)	January 30, 2016	May 2, 2015 (Unaudited)
<b>Assets</b>			
<b>Current assets:</b>			
Cash and cash equivalents	\$238,976	\$260,067	\$326,907
Merchandise inventory	334,301	305,178	332,645
Accounts receivable	73,283	80,912	64,010
Prepaid expenses and other	82,767	77,218	74,132
<b>Total current assets</b>	<b>729,327</b>	<b>723,375</b>	<b>797,694</b>
Property and equipment, at cost, net of accumulated depreciation	706,221	703,586	710,256
Intangible assets, at cost, net of accumulated amortization	51,432	51,832	47,419
Goodwill	17,520	17,186	13,243
Non-current deferred income taxes	38,903	64,927	67,703
Other assets	52,893	51,340	36,445
<b>Total assets</b>	<b>\$1,596,296</b>	<b>\$1,612,246</b>	<b>\$1,672,760</b>
<b>Liabilities and Stockholders' Equity</b>			
<b>Current liabilities:</b>			
Accounts payable	\$202,692	\$182,789	\$203,239
Accrued compensation and payroll taxes	34,838	79,302	40,379
Accrued rent	77,477	77,482	78,741
Accrued income and other taxes	6,915	22,223	6,504
Unredeemed gift cards and gift certificates	38,508	48,274	37,385
Current portion of deferred lease credits	12,850	12,711	13,125
Other liabilities and accrued expenses	45,206	40,901	49,415
<b>Total current liabilities</b>	<b>418,486</b>	<b>463,682</b>	<b>428,788</b>
<b>Non-current liabilities:</b>			
Deferred lease credits	54,738	50,104	57,162
Non-current accrued income taxes	4,675	4,566	10,884
Other non-current liabilities	41,089	42,518	30,521
<b>Total non-current liabilities</b>	<b>100,502</b>	<b>97,188</b>	<b>98,567</b>
Commitments and contingencies	—	—	—
<b>Stockholders' equity:</b>			
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; 180,804, 180,135 and 195,061 shares

outstanding, respectively	2,496	2,496	2,496
Contributed capital	583,689	590,820	563,709
Accumulated other comprehensive loss	(24,484 )	(29,868 )	(11,044 )
Retained earnings	1,675,031	1,659,267	1,545,674
Treasury stock, 68,762, 69,431 and 54,500 shares, respectively	(1,159,424)	(1,171,339)	(955,430 )
Total stockholders' equity	1,077,308	1,051,376	1,145,405
Total liabilities and stockholders' equity	\$1,596,296	\$1,612,246	\$1,672,760

Refer to Notes to Consolidated Financial Statements

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Unaudited)

(In thousands, except per share amounts)	13 Weeks Ended	
	April 30, 2016	May 2, 2015
Total net revenue	\$749,416	\$699,520
Cost of sales, including certain buying, occupancy and warehousing expenses	455,964	437,308
Gross profit	293,452	262,212
Selling, general and administrative expenses	195,993	185,091
Depreciation and amortization expense	38,783	35,127
Operating income	58,676	41,994
Other income, net	4,935	5,970
Income before income taxes	63,611	47,964
Provision for income taxes	23,135	18,909
Net income	\$40,476	\$29,055
Net income per basic share	\$0.22	\$0.15
Net income per diluted share	\$0.22	\$0.15
Cash dividends per common share	\$0.125	\$0.125
Weighted average common shares outstanding - basic	180,697	194,975
Weighted average common shares outstanding - diluted	182,927	195,880
Retained earnings, beginning	\$1,659,267	\$1,543,085
Net income	40,476	29,055
Cash dividends and dividend equivalents	(23,159 )	(24,989 )
Reissuance of treasury stock	(1,553 )	(1,477 )
Retained earnings, ending	\$1,675,031	\$1,545,674

Refer to Notes to Consolidated Financial Statements

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)	13 Weeks Ended	
	April 30, 2016	May 2, 2015
Net income	\$40,476	\$29,055
Other comprehensive income (loss):		
Foreign currency translation income (loss)	5,384	(1,100)
Other comprehensive income (loss):	5,384	(1,100)
Comprehensive income	\$45,860	\$27,955

Refer to Notes to Consolidated Financial Statements

## AMERICAN EAGLE OUTFITTERS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)	13 Weeks Ended April 30, 2016	May 2, 2015
<b>Operating activities:</b>		
Net income	\$ 40,476	\$ 29,055
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	39,080	35,302
Share-based compensation	8,808	8,102
Deferred income taxes	26,058	4,654
Foreign currency transaction gain	(4,612 )	(3,692 )
Changes in assets and liabilities:		
Merchandise inventory	(25,652 )	(52,806 )
Accounts receivable	7,278	3,522
Prepaid expenses and other	(4,876 )	(27 )
Other assets	(592 )	11,334
Accounts payable	4,604	5,070
Unredeemed gift cards and gift certificates	(10,146 )	(10,665 )
Deferred lease credits	4,158	2,517
Accrued compensation and payroll taxes	(44,019 )	(3,670 )
Accrued income and other taxes	(15,138 )	(24,175 )
Accrued liabilities	4,442	(17,252 )
Total adjustments	(10,607 )	(41,786 )
Net cash provided by (used for) operating activities	29,869	(12,731 )
<b>Investing activities:</b>		
	(24,336 )	(41,743 )



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

Capital expenditures for property and equipment		
Acquisition of intangible assets	(758 )	(1,078 )
Net cash used for investing activities	(25,094 )	(42,821 )
Financing activities:		
Payments on capital leases	(681 )	(1,542 )
Repurchase of common stock from employees	(6,749 )	(4,991 )
Net proceeds from stock options exercised	452	1,028
Excess tax benefit from share-based payments	463	594
Cash dividends paid	(22,599 )	(24,381 )
Net cash used for financing activities	(29,114 )	(29,292 )
Effect of exchange rates changes on cash	3,248	1,054
Net decrease in cash and cash equivalents	(21,091 )	(83,790 )
Cash and cash equivalents - beginning of period	260,067	410,697
Cash and cash equivalents - end of period	\$ 238,976	\$ 326,907
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	\$ 27,036	\$ 43,282
Cash paid during the period for interest	\$ 334	\$ 333

Refer to Notes to Consolidated Financial Statements

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 April 30, 2016 and May 2, 2015 and for the 13 week periods ended April 30, 2016 and May 2, 2015 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 2015 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<sup>®</sup> by American Eagle<sup>®</sup> 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 April 30, 2016, 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 2016” refers to the 52 week period ending January 28, 2017. “Fiscal 2015” refers to the 52 week period ended January 30, 2016.

#### 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.

7

---

## 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. Originally, ASU 2014-09 was effective for annual reporting periods beginning after December 15, 2016. In July 2015, the FASB voted to approve amendments deferring the effective date by one year to be effective for annual reporting periods beginning after December 15, 2017. Accordingly, the Company will adopt ASU 2014-09 on February 4, 2018. The Company does not expect a material impact of the adoption of this guidance on its Consolidated Financial Statements, results of operations or cash flows.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes (“ASU 2015-17”), which requires entities to present deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. The ASU may be applied prospectively or retrospectively. The Company adopted the ASU on January 30, 2016, applied retrospectively.

In February 2016, the FASB issued ASU No. 2016-02, Leases (“ASU 2016-02”) which replaces the existing guidance in ASC 840, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years and requires retrospective application. The Company will adopt in Fiscal 2019 and is currently evaluating the impact of ASU 2016-02 to its Consolidated Financial Statements.

In March 2016, the FASB issued ASU No. 2016-09, Compensation—Stock Compensation (Topic 718) (“ASU 2016-09”). ASU 2016-09 makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016. The Company will adopt and is currently evaluating the 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 issuance of gift cards. A current liability is recorded upon issuance, 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.

8

---

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

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

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

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

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

#### Selling, General and Administrative Expenses

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

#### Other Income, Net

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

#### Cash and Cash Equivalents and Investments

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

As of April 30, 2016 and May 2, 2015, the Company held no investments.

Refer to Note 3 to the Consolidated Financial Statements for information regarding cash and cash equivalents 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 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. No long-lived asset impairment charges were recorded during the 13 weeks ended April 30, 2016 or May 2, 2015.

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, Canada, Hong Kong and China businesses and the recent acquisition of Tailgate Clothing Co in Fiscal 2015. 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 January 30, 2016. 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 weeks ended April 30, 2016 or May 2, 2015.

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 issuance, 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 \$2.1 million and \$1.7 million of revenue related to gift card breakage during the 13 weeks ended April 30, 2016 and May 2, 2015, respectively.

#### 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") under the AEO and Aerie brands. These credit cards are issued by a third-party bank (the "Bank") in accordance with a credit card agreement ("the Agreement"). The Company has no liability to the Bank for bad debt expense, provided that purchases are made in accordance with the Bank's procedures. We receive additional funding from the Bank based on the Agreement and card activity. We recognize revenue for the additional funding when the amounts are fixed or determinable and collectability is reasonably assured. This revenue is recorded in other revenue, which is a component of total net revenue in our Consolidated Statements of Operations and Retained Earnings.

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 at AEO and Aerie 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 at AEO and Aerie are accounted for by analogy to ASC 605-25, Revenue Recognition, Multiple Element Arrangements ("ASC 605-25"). The Company believes that points earned 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-AEO 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® 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.

### 3. Cash and Cash Equivalents and 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:

	April 30,	January	May 2,
(In thousands)	2016	2016	2015
Cash and cash equivalents:			
Cash	\$177,820	\$205,359	\$234,190
Money-market	61,156	54,708	92,717
Total cash and cash equivalents	\$238,976	\$260,067	\$326,907

There were no sales or purchases of investments for the 13 weeks ended April 30, 2016 and May 2, 2015.

### 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.

#### 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 April 30, 2016 and May 2, 2015, the Company held certain assets that are required to be measured at fair value on a recurring basis. These include cash and cash equivalents.

In accordance with ASC 820, the following table represents the Company's fair value hierarchy for its financial assets (cash equivalents) measured at fair value on a recurring basis at April 30, 2016 and May 2, 2015:

Fair Value Measurements at April 30, 2016				
Quoted Market				
Prices in Active				
Markets for				
Significant				
Identical				
Significant Other				
Unobservable				
Assets				
Observable Inputs				
Inputs				
(In thousands)	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
Cash and cash equivalents:				
Cash	\$ 177,820	\$ 177,820	—	—
Money-market	61,156	61,156	—	—
Total cash and cash equivalents	\$ 238,976	\$ 238,976	—	—

Fair Value Measurements at May 2, 2015				
Quoted Market				
Prices in Active				
Markets for				
Identical				
Assets				
Significant Other Unobservable				
Observable Inputs Inputs				
(In thousands)	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
Cash and cash equivalents:				
Cash	\$234,190	\$ 234,190	—	—
Money-market	92,717	92,717	—	—
Total cash and cash equivalents	\$326,907	\$ 326,907	\$ —	\$ —

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 April 30, 2016 or May 2, 2015.

#### 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.

#### 5. Earnings per Share

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

(In thousands)	13 Weeks Ended	
	April 30, 2016	May 2, 2015
Weighted average common shares outstanding:		
Basic number of common shares outstanding	180,697	194,975
Dilutive effect of stock options and non-vested		
restricted stock	2,230	905
Diluted number of common shares outstanding	182,927	195,880

Equity awards to purchase approximately 1.4 million shares of common stock during the 13 weeks ended April 30, 2016 and 40,000 shares of common stock during the 13 weeks ended May 2, 2015 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.

Additionally, approximately 0.7 million shares of restricted stock units for the 13 weeks ended April 30, 2016 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:

(In thousands)	April 30, 2016	January 30, 2016	May 2, 2015
Property and equipment, at cost	\$1,802,838	\$1,792,382	\$1,726,207
Less: Accumulated depreciation	(1,096,617)	(1,088,796)	(1,015,951)
Property and equipment, net	\$706,221	\$703,586	\$710,256

## 7. Intangible Assets

Intangible assets consist of the following:

(In thousands)	April 30, 2016	January 30, 2016	May 2, 2015
Trademarks and other intangibles, at cost	\$68,155	\$67,398	\$60,462
Less: Accumulated amortization	(16,723)	(15,566)	(13,043)
Intangible assets, net	\$51,432	\$51,832	\$47,419

## 8. Other Credit Arrangements

In Fiscal 2014, the Company entered into a 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 take advantage of a favorable credit environment.

All obligations under the Credit Facilities are unconditionally guaranteed by certain subsidiaries. The obligations under the 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 have been further secured by first-priority mortgages on certain real property.

As of April 30, 2016, the Company was in compliance with the terms of the Credit Agreement and had \$8.0 million outstanding in stand-by letters of credit. No loans were outstanding under the Credit Agreement as of April 30, 2016.

Additionally, the Company has a borrowing agreement with one financial institution under which it may borrow an aggregate of \$5.0 million USD for the purposes of trade letter of credit issuances. The availability of any future borrowings under the trade letter of credit facilities is subject to acceptance by the financial institution.

As of April 30, 2016, the Company had no outstanding trade letters of credit.

## 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 weeks ended April 30, 2016 and May 2, 2015 was \$8.8 million (\$5.6 million, net of tax) and \$8.1 million (\$4.9 million, net of tax) respectively.

### Stock Option Grants



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

The Company grants both time-based and performance-based stock options. A summary of the Company's stock option activity for the 13 weeks ended April 30, 2016 follows:

	Options (In thousands)	Weighted- Average Exercise Price	Weighted- Remaining Contractual Term (In years)	Aggregate Intrinsic Value (In thousands)
Outstanding - January 30, 2016	1,213	\$ 14.83		
Exercised (1)	38	\$ 12.03		
Cancelled	42	\$ 14.50		
Outstanding - April 30, 2016	1,133	\$ 14.93	0.8	314
Vested and expected to vest - April 30, 2016	1,133	\$ 14.93	0.8	314
Exercisable - April 30, 2016 (2)	417	\$ 13.56	0.8	314

14

(1) Options exercised during the 13 weeks ended April 30, 2016 had exercise prices ranging from \$11.50 to \$13.70.  
 (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 April 30, 2016.

Cash received from the exercise of stock options was \$0.5 million for the 13 weeks ended April 30, 2016 and \$1.0 million for the 13 weeks ended May 2, 2015. The actual tax benefit (expense) realized from stock option exercises totaled \$0.1 million for the 13 weeks ended April 30, 2016 and (\$0.2) million for the 13 weeks ended May 2, 2015.

There were no stock options granted during the 13 weeks ended April 30, 2016 and May 2, 2015.

As of April 30, 2016, there was no unrecognized compensation expense for stock option awards.

#### 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.

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		Performance-Based Restricted	
	Stock Units 13 Weeks Ended April 30, 2016		Stock Units 13 Weeks Ended April 30, 2016	
	Weighted		Weighted	
	-Average		-Average	
	Grant Date		Grant Date	
(Shares in thousands)	Shares	Fair Value	Shares	Fair Value
Nonvested - January 30, 2016	1,935	\$ 15.17	2,609	\$ 16.02
Granted	800	\$ 16.09	613	\$ 16.09
Vested	(781 )	\$ 16.14	(115 )	\$ 14.82
Cancelled	(39 )	\$ 14.36	(689 )	\$ 19.74

Nonvested - April 30, 2016	1,915	\$ 15.18	2,418	\$ 15.03
----------------------------	-------	----------	-------	----------

As of April 30, 2016, there was \$25.7 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 2.2 years. Based on current probable performance, there is \$10.3 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 April 30, 2016, the Company had 6.3 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 for the 13 weeks ended April 30, 2016 was 36.4% compared to 39.4% for the 13 weeks ended May 2, 2015. The decrease in the effective income tax rate this year is primarily due to an increase in world-wide earnings and a decrease to the valuation allowance on foreign deferred tax assets.

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 April 30, 2016. Over the next twelve months, the Company believes that it is reasonably possible that unrecognized tax benefits may decrease by approximately \$3.0 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 the operations of the Company.

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 for the thirteen week periods ended April 30, 2016 and May 2, 2015, 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 April 30, 2016 and May 2, 2015, and the related consolidated statements of operations and retained earnings, comprehensive income and cash flows for the thirteen week periods ended April 30, 2016 and May 2, 2015. 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 January 30, 2016, 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 10, 2016. In our opinion, the accompanying consolidated balance sheet of American Eagle Outfitters, Inc. as of January 30, 2016, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Pittsburgh, Pennsylvania

May 24, 2016

## 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 2015 Management's Discussion and Analysis of Financial Condition and Results of Operations which can be found in our Fiscal 2015 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 15 to 20 AEO stores and 10 Aerie stores in North America and continued international expansion during Fiscal 2016;
  - 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 55 to 65 American Eagle Outfitters stores in the United States and Canada for remodeling and refurbishing during Fiscal 2016;
  - the potential closure of approximately 30 to 35 American Eagle Outfitters and 15 Aerie stores in the United States and Canada during Fiscal 2016;
  - the planned opening of approximately 30 new international third party operated American Eagle Outfitters stores during Fiscal 2016;
  - the success of our core American Eagle Outfitters and Aerie brands through our omni-channel outlets 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 2015 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 open at least one year over the comparable prior year period, as well as the AEO Direct business. In fiscal years following those with 53 weeks, 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.
- 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 and certain promotional costs (collectively “merchandise 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 first quarter performance remained strong, continuing the momentum from Fiscal 2015. Compelling product and an improved customer experience drove sales and margin growth across brands. Comparable sales were positive for both the AE and Aerie brands. E-commerce was exceptionally strong, as increased digital marketing efforts and site improvements are delivering returns. Comparable store sales were also positive, despite soft mall traffic. Favorable product costs resulted in margin expansion and expense discipline allowed for leverage of operating expense and occupancy costs. We ended the quarter in solid financial condition, with \$239 million in cash and no debt.

Total net revenue increased 7% to \$749.4 million and consolidated comparable sales, including AEO Direct, increased 6%, following a 7% increase last year. By brand, American Eagle Outfitters comparable sales increased 4% while Aerie increased 32%.

Gross profit rose 12% to \$293.5 million compared to \$262.2 million last year and increased 170 basis points to 39.2% as a rate to total net revenue. The increase was the result of leverage in occupancy costs and lower product costs, offset by an increase in markdowns.

Operating income for the first quarter was \$58.7 million compared to \$42.0 million last year and leveraged 180 basis points. Net income the quarter was \$40.5 million, or \$0.22 per diluted share, compared to \$29.1 million, or \$0.15 per diluted share, last year.

We had \$239.0 million in cash and cash equivalents as of April 30, 2016. Merchandise inventory at the end of the first quarter was \$334.3 million, compared to \$332.6 million last year.

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.

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	
	April 30, 2016	May 2, 2015
Total net revenue	100.0%	100.0%
Cost of sales, including certain buying, occupancy and warehousing expenses	60.8	62.5
Gross profit	39.2	37.5
Selling, general and administrative expenses	26.2	26.5
Depreciation and amortization expense	5.2	5.0
Operating income	7.8	6.0
Other income, net	0.7	0.9
Income before income taxes	8.5	6.9
Provision for income taxes	3.1	2.7
Net Income	5.4 %	4.2 %



The following table shows our consolidated store data:

	13 Weeks Ended	
	April 30, 2016	May 2, 2015
Number of stores:		
Beginning of period	1,047	1,056
Opened	3	4
Closed	(4	) (6
End of period	1,046	1,054
Total gross square feet at end of period	6,601,780	6,619,939
International licensed/franchise stores at end of		
period (1)	145	109

(1) 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 950 American Eagle Outfitters retail stores, 95 Aerie stand-alone retail stores and AEO Direct.

Comparison of the 13 weeks ended April 30, 2016 to the 13 weeks ended May 2, 2015

#### Total net revenue

Total net revenue increased 7% to \$749.4 million compared to \$699.5 million last year. The increase resulted primarily from a consolidated comparable sales increase of 6% for the period. By brand, including the respective AEO Direct sales, American Eagle Outfitters brand comparable sales increased 4%, or \$25.3 million, and Aerie brand comparable sales increased 32%, or \$15.1 million.

Total comparable sales for AE women's increased 9% and men's decreased 3%. For the first quarter, the average transaction value increased 6%, driven by a 5% increase in our AUR. Strength in our AUR was driven by more compelling and higher quality merchandise.

#### Gross Profit

Gross profit increased 12% to \$293.5 million compared to \$262.2 million last year. As a rate to total net revenue, gross profit was 39.2% compared to 37.5% in the same quarter last year. The increase was primarily the result of buying, occupancy, and warehousing costs leveraging 110 basis points, primarily due to occupancy cost leverage. Additionally, the remaining 60 basis points of improvement was the result of favorable product costs, offset by a modest increase in markdowns.

There was \$4.3 million and \$4.4 million of share-based payment expense included in gross profit for the periods ended April 30, 2016 and May 2, 2015, respectively, comprised of both time and performance-based awards.

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 increased 6% to \$196.0 million from \$185.1 million last year. As a rate to total net revenue, SG&A expenses decreased 30 basis points to 26.2%. SG&A expense increased due to investments in advertising, variable selling expenses and other strategic initiatives.

There was \$4.5 million and \$3.6 million of share-based payment expense included in SG&A expenses for the periods ended April 30, 2016 and May 2, 2015, respectively, comprised of both time and performance-based awards.

### Depreciation and Amortization Expense

Depreciation and amortization expense increased to \$38.8 million, compared to \$35.1 million last year. As a rate to total net revenue, depreciation and amortization expense was 5.2% this year as compared to 5.0% last year. The increase was driven by omni-channel and IT technology investments

### Other Income, Net

Other income of \$4.9 million was comprised primarily of currency gains on cash held in Canadian dollars. This compares to other income of \$6.0 million last year.

### 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 for the 13 weeks ended April 30, 2016 was 36.4% compared to 39.4% for the 13 weeks ended May 2, 2015. The decrease in the effective income tax rate this year is primarily due to an increase in world-wide earnings and a decrease to the valuation allowance on foreign deferred tax assets.

### Net Income

Net income increased to \$40.5 million, or 5.4% as a percent to total net revenue, from \$29.1 million, or 4.2% as a percent to total net revenue last year. Net income per diluted share increased to \$0.22 per diluted share from \$0.15 per diluted share in the prior year. The change in net income is attributable to the factors noted above.

### 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 April 30, 2016, we had 145 stores operated by our third party operators in 22 countries. International third party operated stores are not included in the consolidated store data or the total gross square feet calculation.

As of April 30, 2016, we had 100 company-operated stores in Canada, 23 in Mexico, 6 in Hong Kong, 9 in China, 6 in Puerto Rico, and 3 in the United Kingdom. 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.

### 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.

22

---

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

As of April 30, 2016, we held certain assets that are required to be measured at fair value on a recurring basis. These include cash and 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 April 30, 2016:

Fair Value Measurements at April 30, 2016				
Quoted Market				
Prices in Active				
Markets for				
Significant				
Identical				
Significant Other				
Unobservable				
Assets				
Observable Inputs				
Inputs				
(In thousands)	Carrying Amount	(Level 1)	(Level 2)	(Level 3)
Cash and cash equivalents:				
Cash	\$ 177,820	\$ 177,820	—	—
Money-market	61,156	61,156	—	—
Total cash and cash equivalents	\$ 238,976	\$ 238,976	—	—

### 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 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.

Our growth strategy includes fortifying our brands and 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:

	April 30, 2016	January 30, 2016	May 2, 2015
Working Capital (in thousands)	\$310,841	\$259,693	\$368,906
Current Ratio	1.74	1.56	1.86



Working capital increased \$51.1 million compared to January 30, 2016 and decreased \$58.1 million compared to last year. Our operating cash flows have been sufficient to fund our use of cash for financing and investing activities including capital expenditures and the distribution of cash to shareholders through the payment of dividends and share repurchases.

#### Cash Flows from Operating Activities

Net cash provided by (used for) operating activities from continuing operations totaled \$29.9 million and \$(12.7) million for the 13 weeks ended April 30, 2016 and May 2, 2015, 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 was primarily driven by increased earnings levels resulting from positive sales results and margin growth.

#### Cash Flows from Investing Activities

Investing activities from continuing operations for the 13 weeks ended April 30, 2016 primarily consisted of \$(24.3) million of capital expenditures for property and equipment. Investing activities for the 13 weeks ended May 2, 2015 primarily included \$(41.7) million of capital expenditures for property and equipment.

### Cash Flows from Financing Activities

Cash used for financing activities from continuing operations for the 13 weeks ended April 30, 2016 consisted primarily of \$22.6 million for cash dividends paid at a quarterly rate of \$0.125 per share, \$6.7 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payment and \$0.7 million for the payments on capital leases, partially offset by \$0.5 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 13 weeks ended May 2, 2015 consisted primarily of \$24.4 million for cash dividends paid at a quarterly rate of \$0.125 per share, \$5.0 million for the repurchase of common stock from employees for the payment of taxes in connection with the vesting of share-based payment and \$1.5 million for the payments on capital leases, partially offset by \$1.0 million of net proceeds from stock option exercises. There were no purchases of common stock from publically announced programs during the 13 weeks ended May 2, 2015.

### Credit Facilities

In Fiscal 2014, we entered into a 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 \$400.0 million, subject to customary borrowing base limitations. The Credit Facilities provide increased financial flexibility and take advantage of a favorable credit environment.

All obligations under the Credit Facilities are unconditionally guaranteed by certain subsidiaries. The obligations under the 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 have been further secured by first-priority mortgages on certain real property.

As of April 30, 2016, we were in compliance with the terms of the Credit Agreement and had \$8.0 million outstanding in stand-by letters of credit. No loans were outstanding under the Credit Agreement on April 30, 2016.

Additionally, we have a borrowing agreement with one financial institution under which we may borrow an aggregate of \$5.0 million for the purposes of trade letter of credit issuances. The availability of any future borrowings under the trade letter of credit facilities is subject to acceptance by the respective financial institutions.

As of April 30, 2016, we had no outstanding trade letters of credit.

### Capital Expenditures for Property and Equipment

Capital expenditures for the 13 weeks ended April 30, 2016 were \$24.3 million and included \$14.7 million related to investments in our stores, including 3 new AE stores and 12 remodels. Additionally, we continued to support our infrastructure growth by investing in information technology initiatives (\$2.2 million), other home office projects (\$2.8 million), the improvement and expansion of our distribution centers (\$0.3 million) and investments in e-commerce (\$4.3 million).

For Fiscal 2016, we expect capital expenditures to be approximately \$160 to \$170 million related to the continued support of our expansion efforts, stores, information technology upgrades to support growth and investments in e-commerce.

### Stock Repurchases

During the 13 weeks ended April 30, 2016 and May 2, 2015, there were no share repurchases as a part of our publicly announced repurchase programs. As of April 30, 2016, we had 2.8 million shares remaining authorized for repurchase

under the program authorized by our Board in January 2013. During the 13 weeks ended April 30, 2016, our Board authorized the repurchase of 25.0 million shares under a new share repurchase program which expires on January 30, 2021, bringing our total repurchase authorization to 27.8 million.

During the 13 weeks ended April 30, 2016 and May 2, 2015, we repurchased approximately 0.4 million and 0.3 million shares, respectively, from certain employees at market prices totaling \$6.7 million and \$5.0 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 our equity incentive plans. The aforementioned shares repurchased have been recorded as treasury stock.

## Dividends

During the 13 weeks ended April 30, 2016, our Board declared a quarterly cash dividend of \$0.125 per share, which was paid on April 22, 2016. 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 January 30, 2016 contained in our Fiscal 2015 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.

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

There were no material changes in our exposure to market risk from January 30, 2016. Our market risk profile as of January 30, 2016 is disclosed in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, of our Fiscal 2015 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 April 30, 2016, 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 April 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

## ITEM 1A. RISK FACTORS.

Risk factors that affect our business and financial results are discussed within Item 1A of our Fiscal 2015 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 2015 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 April 30, 2016.

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share (2)	Total Number of Shares Purchased as Part of Publicly Announced Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Program (1) (3)
Month #1 (January 31, 2016 through February 27, 2016)	4,685	\$ 14.20	—	27,837,016
Month #2 (February 28, 2016 through April 2, 2016)	429,767	\$ 15.26	—	27,837,016
Month #3 (April 3, 2016 through April 30, 2016)	2,521	\$ 15.63	—	27,837,016
Total	436,973	\$ 15.26	—	27,837,016

(1) During the 13 weeks ended April 30, 2016 there were no shares repurchased as part of our publicly announced share repurchase program and there were 436,973 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 2.8 million shares that may yet be purchased expires on January 28, 2017. During the 13 weeks ended April 30, 2016, our Board authorized 25.0 million shares under a new share repurchase program which expires on January 30, 2021, bringing our total repurchase authorization outstanding to 27.8 million.



ITEM 6. EXHIBITS.

- \* Exhibit 10.1 Employment Agreement between the Registrant and Peter Horvath, dated May 4, 2016
  
  - \* 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 Scott M. Hurd 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.



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: May 24, 2016

American Eagle Outfitters, Inc.

(Registrant)

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

By: /s/ Scott M. Hurd  
Scott M. Hurd  
Senior Vice President, Chief Accounting Officer

and Interim Chief Financial Officer  
(Principal Financial Officer)