

BIG 5 SPORTING GOODS CORP  
Form 10-Q  
November 02, 2012

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, DC 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2012

**OR**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-49850

**BIG 5 SPORTING GOODS CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or Other Jurisdiction of Incorporation or Organization)

**95-4388794**  
(I.R.S. Employer Identification No.)

**2525 East El Segundo Boulevard**  
**El Segundo, California**  
(Address of Principal Executive Offices)

**90245**  
(Zip Code)

**Registrant's telephone number, including area code: (310) 536-0611**

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

There were 21,580,618 shares of common stock, with a par value of \$0.01 per share outstanding as of October 25, 2012.

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**BIG 5 SPORTING GOODS CORPORATION**

**INDEX**

|  | <b>Page</b>  |
|--|--|
| <b><u>PART I FINANCIAL INFORMATION</u></b> |  |
| Item 1                                     | <u>Financial Statements</u>  |
|  | <u>Unaudited Condensed Consolidated Balance Sheets at September 30, 2012 and January 1, 2012</u> 3   |
|  | <u>Unaudited Condensed Consolidated Statements of Operations for the Thirteen and Thirty-Nine Weeks Ended September 30, 2012 and October 2, 2011</u> 4 |
|  | <u>Unaudited Condensed Consolidated Statements of Cash Flows for the Thirty-Nine Weeks Ended September 30, 2012 and October 2, 2011</u> 5              |
|  | <u>Notes to Unaudited Condensed Consolidated Financial Statements</u> 6  |
|  | <u>Report of Independent Registered Public Accounting Firm</u> 20  |
| Item 2                                     | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> 21  |
| Item 3                                     | <u>Quantitative and Qualitative Disclosures About Market Risk</u> 34   |
| Item 4                                     | <u>Controls and Procedures</u> 34  |
| <b><u>PART II OTHER INFORMATION</u></b>    |  |
| Item 1                                     | <u>Legal Proceedings</u> 35  |
| Item 1A                                    | <u>Risk Factors</u> 36   |
| Item 2                                     | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 36  |
| Item 3                                     | <u>Defaults Upon Senior Securities</u> 37  |
| Item 4                                     | <u>Mine Safety Disclosures</u> 37  |
| Item 5                                     | <u>Other Information</u> 37  |
| Item 6                                     | <u>Exhibits</u> 38   |
| <b><u>SIGNATURES</u></b> 39                |  |

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****BIG 5 SPORTING GOODS CORPORATION****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share amounts)

|   | September 30,<br>2012 | January 1,<br>2012 |
|---|-----------------------|--------------------|
| <b>ASSETS</b>   |                       |                    |
| Current assets:   |                       |                    |
| Cash and cash equivalents   | \$ 4,997              | \$ 4,900           |
| Accounts receivable, net of allowances of \$113 and \$142, respectively   | 9,439                 | 13,106             |
| Merchandise inventories, net  | 275,838               | 264,278            |
| Prepaid expenses  | 8,443                 | 7,972              |
| Deferred income taxes   | 9,083                 | 8,410              |
| Total current assets  | 307,800               | 298,666            |
| Property and equipment, net   | 70,748                | 75,369             |
| Deferred income taxes   | 14,353                | 13,236             |
| Other assets, net of accumulated amortization of \$573 and \$383, respectively  | 2,090                 | 2,360              |
| Goodwill  | 4,433                 | 4,433              |
| Total assets  | \$ 399,424            | \$ 394,064         |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                       |                    |
| Current liabilities:  |                       |                    |
| Accounts payable  | \$ 92,314             | \$ 77,593          |
| Accrued expenses  | 60,885                | 62,547             |
| Current portion of capital lease obligations  | 1,686                 | 1,617              |
| Total current liabilities   | 154,885               | 141,757            |
| Deferred rent, less current portion   | 21,575                | 22,483             |
| Capital lease obligations, less current portion   | 3,025                 | 3,145              |
| Long-term debt  | 52,574                | 63,476             |
| Other long-term liabilities   | 7,057                 | 6,613              |
| Total liabilities   | 239,116               | 237,474            |
| Commitments and contingencies   |                       |                    |
| Stockholders' equity:   |                       |                    |
| Common stock, \$0.01 par value, authorized 50,000,000 shares; issued 23,603,104 and 23,483,815 shares, respectively; outstanding 21,601,268 and 21,890,970 shares, respectively | 236                   | 235                |
| Additional paid-in capital  | 100,565               | 99,665             |
| Retained earnings   | 85,049                | 79,037             |
| Less: Treasury stock, at cost; 2,001,836 and 1,592,845 shares, respectively   | (25,542)              | (22,347)           |
| Total stockholders' equity  | 160,308               | 156,590            |
| Total liabilities and stockholders' equity  | \$ 399,424            | \$ 394,064         |

See accompanying notes to unaudited condensed consolidated financial statements.

**BIG 5 SPORTING GOODS CORPORATION****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

|  | 13 Weeks Ended        |                    | 39 Weeks Ended        |                    |
|--|-----------------------|--------------------|-----------------------|--------------------|
|  | September 30,<br>2012 | October 2,<br>2011 | September 30,<br>2012 | October 2,<br>2011 |
| Net sales  | \$ 251,774            | \$ 234,680         | \$ 696,882            | \$ 675,411         |
| Cost of sales  | 167,901               | 157,691            | 472,505               | 454,497            |
| Gross profit   | 83,873                | 76,989             | 224,377               | 220,914            |
| Selling and administrative expense                   | 70,384                | 67,484             | 205,560               | 201,590            |
| Operating income                                     | 13,489                | 9,505              | 18,817                | 19,324             |
| Interest expense                                     | 469                   | 632                | 1,645                 | 1,838              |
| Income before income taxes                           | 13,020                | 8,873              | 17,172                | 17,486             |
| Income taxes   | 4,851                 | 3,056              | 6,289                 | 5,804              |
| Net income   | \$ 8,169              | \$ 5,817           | \$ 10,883             | \$ 11,682          |
| Earnings per share:                                  |                       |                    |                       |                    |
| Basic  | \$ 0.38               | \$ 0.27            | \$ 0.51               | \$ 0.54            |
| Diluted  | \$ 0.38               | \$ 0.27            | \$ 0.50               | \$ 0.53            |
| Dividends per share                                  | \$ 0.075              | \$ 0.075           | \$ 0.225              | \$ 0.225           |
| Weighted-average shares of common stock outstanding: |                       |                    |                       |                    |
| Basic  | 21,325                | 21,689             | 21,413                | 21,660             |
| Diluted  | 21,480                | 21,791             | 21,588                | 21,874             |

See accompanying notes to unaudited condensed consolidated financial statements.

## BIG 5 SPORTING GOODS CORPORATION

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|   | 39 Weeks Ended        |                    |
|---|-----------------------|--------------------|
|   | September 30,<br>2012 | October 2,<br>2011 |
| Cash flows from operating activities:   |                       |                    |
| Net income  | \$ 10,883             | \$ 11,682          |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                       |                    |
| Depreciation and amortization   | 14,135                | 13,775             |
| Impairment of store assets  | 208                   | 576                |
| Share-based compensation  | 1,317                 | 1,340              |
| Excess tax benefit related to share-based awards  | (12)                  | (85)               |
| Amortization of debt issuance costs   | 190                   | 245                |
| Deferred income taxes   | (1,790)               | 263                |
| Gain on disposal of property and equipment  | (8)                   | (244)              |
| Changes in operating assets and liabilities:  |                       |                    |
| Accounts receivable, net  | 3,417                 | 6,236              |
| Merchandise inventories, net  | (11,560)              | (25,824)           |
| Prepaid expenses and other assets   | (391)                 | (196)              |
| Accounts payable  | 15,223                | (5,827)            |
| Accrued expenses and other long-term liabilities  | (3,083)               | (13,511)           |
| Net cash provided by (used in) operating activities   | 28,529                | (11,570)           |
| Cash flows from investing activities:   |                       |                    |
| Purchases of property and equipment   | (7,275)               | (7,816)            |
| Proceeds from solar energy rebate   | 250                   | 500                |
| Proceeds from disposal of property and equipment  |                       | 502                |
| Net cash used in investing activities   | (7,025)               | (6,814)            |
| Cash flows from financing activities:   |                       |                    |
| Principal borrowings under revolving credit facility  | 150,490               | 165,614            |
| Principal payments under revolving credit facility  | (161,392)             | (144,811)          |
| Changes in book overdraft   | (933)                 | 3,075              |
| Principal payments under capital lease obligations  | (1,323)               | (1,573)            |
| Proceeds from exercise of share option awards   | 97                    | 283                |
| Excess tax benefit related to share-based awards  | 12                    | 85                 |
| Purchases of treasury stock   | (3,195)               |                    |
| Tax withholding payments for share-based compensation                                       | (282)                 | (283)              |
| Dividends paid  | (4,881)               | (4,903)            |
| Net cash (used in) provided by financing activities   | (21,407)              | 17,487             |
| Net increase (decrease) in cash and cash equivalents  | 97                    | (897)              |
| Cash and cash equivalents at beginning of period  | 4,900                 | 5,620              |
| Cash and cash equivalents at end of period  | \$ 4,997              | \$ 4,723           |
| Supplemental disclosures of non-cash investing and financing activities:                    |                       |                    |
| Property and equipment acquired under capital leases  | \$ 1,335              | \$ 2,285           |

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|  |          |          |
|--|----------|----------|
| Property and equipment purchases accrued           | \$ 1,914 | \$ 2,221 |
| Solar energy rebate receivable                     | \$       | \$ 250   |
| Supplemental disclosures of cash flow information: |          |          |
| Interest paid                                      | \$ 1,530 | \$ 1,486 |
| Income taxes paid                                  | \$ 1,749 | \$ 2,679 |

See accompanying notes to unaudited condensed consolidated financial statements.



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**BIG 5 SPORTING GOODS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Description of Business**

*Business*

Big 5 Sporting Goods Corporation (the Company) is a leading sporting goods retailer in the western United States, operating 407 stores in 12 states at September 30, 2012. The Company provides a full-line product offering in a traditional sporting goods store format that averages approximately 11,000 square feet. The Company's product mix includes athletic shoes, apparel and accessories, as well as a broad selection of outdoor and athletic equipment for team sports, fitness, camping, hunting, fishing, tennis, golf, snowboarding and roller sports. The Company is a holding company that operates as one business segment through Big 5 Corp., its wholly-owned subsidiary, and Big 5 Services Corp., which is a wholly-owned subsidiary of Big 5 Corp. Big 5 Services Corp. provides a centralized operation for the issuance and administration of gift cards.

The accompanying interim unaudited condensed consolidated financial statements (Interim Financial Statements) of the Company and its wholly-owned subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and are presented in accordance with the requirements of Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these Interim Financial Statements do not include all of the information and notes required by GAAP for complete financial statements. These Interim Financial Statements should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended January 1, 2012 included in the Company's Annual Report on Form 10-K. In the opinion of management, the Interim Financial Statements included herein contain all adjustments, including normal recurring adjustments, considered necessary to present fairly the Company's financial position, the results of operations and cash flows for the periods presented.

The operating results and cash flows of the interim periods presented herein are not necessarily indicative of the results to be expected for any other interim period or the full year.

**(2) Summary of Significant Accounting Policies**

*Consolidation*

The accompanying Interim Financial Statements include the accounts of Big 5 Sporting Goods Corporation, Big 5 Corp. and Big 5 Services Corp. Intercompany balances and transactions have been eliminated in consolidation.

*Reporting Period*

The Company follows the concept of a 52-53 week fiscal year, which ends on the Sunday nearest December 31. Fiscal year 2012 is comprised of 52 weeks and ends on December 30, 2012. Fiscal year 2011 was comprised of 52 weeks and ended on January 1, 2012. The fiscal interim periods in fiscal 2012 and 2011 are each comprised of 13 weeks.

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**BIG 5 SPORTING GOODS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

*Recently Issued Accounting Updates*

In September 2011, the Financial Accounting Standards Board issued Accounting Standards Update ( ASU ) No. 2011-08, *Intangibles - Goodwill and Other*. ASU No. 2011-08 is intended to simplify goodwill impairment testing by adding a qualitative review step to assess whether the required quantitative impairment analysis that exists today is necessary. ASU No. 2011-08 permits an entity to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, it is necessary to perform the currently prescribed two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. Additionally, an entity has the option to bypass the qualitative assessment in any period and proceed directly to performing the first step of the two-step goodwill impairment test. An entity may resume performing the qualitative assessment in any subsequent period. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of ASU No. 2011-08 in fiscal 2012 did not have a material impact on the Company's Interim Financial Statements.

*Use of Estimates*

Management has made a number of estimates and assumptions relating to the reporting of assets, liabilities and stockholders' equity and the disclosure of contingent assets and liabilities at the date of the Interim Financial Statements and reported amounts of revenue and expense during the reporting period to prepare these Interim Financial Statements in conformity with GAAP. Certain items subject to such estimates and assumptions include the carrying amount of merchandise inventories, property and equipment, and goodwill; valuation allowances for receivables, sales returns and deferred income tax assets; estimates related to gift card breakage and the valuation of share-based compensation awards; and obligations related to asset retirements, litigation, self-insurance liabilities and employee benefits. Actual results could differ significantly from these estimates under different assumptions and conditions.

*Revenue Recognition*

The Company earns revenue by selling merchandise primarily through its retail stores. Revenue is recognized when merchandise is sold and delivered to the customer and is shown net of estimated returns during the relevant period. The allowance for sales returns is estimated based upon historical experience.

Cash received from the sale of gift cards is recorded as a liability, and revenue is recognized upon the redemption of the gift card or when it is determined that the likelihood of redemption is remote ( gift card breakage ) and no liability to relevant jurisdictions exists. The Company determines the gift card breakage rate based upon historical redemption patterns and recognizes gift card breakage on a straight-line basis over the estimated gift card redemption period (20 quarters as of the end of the third quarter of fiscal 2012). The Company recognized \$104,000 and \$311,000 in gift card breakage revenue for the 13 and 39 weeks ended September 30, 2012, respectively, compared to \$104,000 and \$314,000 in gift card breakage revenue for the 13 and 39 weeks ended October 2, 2011, respectively.

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**BIG 5 SPORTING GOODS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

The Company records sales tax collected from its customers on a net basis, and therefore excludes it from revenue as defined in Accounting Standards Codification ( ASC ) 605, *Revenue Recognition*.

*Share-Based Compensation*

The Company accounts for its share-based compensation in accordance with ASC 718, *Compensation - Stock Compensation*. The Company recognizes compensation expense on a straight-line basis over the requisite service period using the fair-value method for share option awards, nonvested share awards and nonvested share unit awards granted with service-only conditions. See Note 9 to the Interim Financial Statements for a further discussion on share-based compensation.

*Valuation of Merchandise Inventories*

The Company's merchandise inventories are made up of finished goods and are valued at the lower of cost or market using the weighted-average cost method that approximates the first-in, first-out ( FIFO ) method. Average cost includes the direct purchase price of merchandise inventory, net of certain vendor allowances and cash discounts, and allocated overhead costs associated with the Company's distribution center.

Management regularly reviews inventories and records valuation reserves for merchandise damage and defective returns, merchandise items with slow-moving or obsolescence exposure and merchandise that has a carrying value that exceeds market value. Because of its merchandise mix, the Company has not historically experienced significant occurrences of obsolescence.

Inventory shrinkage is accrued as a percentage of merchandise sales based on historical inventory shrinkage trends. The Company performs physical inventories of its stores at least once per year and cycle counts inventories at its distribution center throughout the year. The reserve for inventory shrinkage represents an estimate for inventory shrinkage for each store since the last physical inventory date through the reporting date.

These reserves are estimates, which could vary significantly, either favorably or unfavorably, from actual results if future economic conditions, consumer demand and competitive environments differ from expectations.

*Valuation of Long-Lived Assets*

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Long-lived assets are reviewed for recoverability at the lowest level in which there are identifiable cash flows ( asset group ), usually at the store level. The carrying amount of an asset group is not considered recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset group. If the asset group is determined not to be recoverable, then an impairment charge will be recognized in the amount by which the carrying amount of the asset group exceeds its fair value, determined using discounted cash flow valuation techniques, as defined in ASC 360, *Property, Plant, and Equipment*.

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**BIG 5 SPORTING GOODS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

The Company determines the sum of the undiscounted cash flows expected to result from the asset group by projecting future revenue, gross margin and operating expense for each store under consideration for impairment. The estimates of future cash flows involve management judgment and are based upon assumptions about expected future operating performance. Assumptions used in these forecasts are consistent with internal planning, and include assumptions about sales growth rates, gross margins and operating expense in relation to the current economic environment and future expectations, competitive factors in various markets and inflation. The actual cash flows could differ from management's estimates due to changes in business conditions, operating performance and economic conditions.

See Note 3 to the Interim Financial Statements for a further discussion of the impairment of long-lived assets.

*Leases and Deferred Rent*

The Company accounts for its leases under the provisions of ASC 840, *Leases*.

The Company evaluates and classifies its leases as either operating or capital leases for financial reporting purposes. Operating lease commitments consist principally of leases for the Company's retail store facilities, distribution center and corporate office. Capital lease obligations consist principally of leases for some of the Company's distribution center delivery tractors, management information systems hardware and point-of-sale equipment for the Company's stores.

Certain of the leases for the Company's retail store facilities provide for payments based on future sales volumes at the leased location, which are not measurable at the inception of the lease. These contingent rents are expensed as they accrue.

Deferred rent represents the difference between rent paid and the amounts expensed for operating leases. Certain leases have scheduled rent increases, and certain leases include an initial period of free or reduced rent as an inducement to enter into the lease agreement (rent holidays). The Company recognizes rent expense for rent increases and rent holidays on a straight-line basis over the term of the underlying leases, without regard to when rent payments are made. The calculation of straight-line rent is based on the reasonably assured lease term as defined in ASC 840 and may exceed the initial non-cancelable lease term.

Landlord allowances for tenant improvements, or lease incentives, are recorded as deferred rent and amortized on a straight-line basis over the lease term as a component of rent expense.

**(3) Impairment of Long-Lived Assets**

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In the second quarter of fiscal 2012 and 2011, the Company recognized pre-tax non-cash impairment charges of \$0.2 million and \$0.6 million, respectively, related to certain underperforming stores. The weak sales performance, coupled

## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

with future undiscounted cash flow projections, indicated that the carrying value of these stores' assets exceeded their estimated fair values as determined by their future discounted cash flow projections. When projecting the stream of future cash flows associated with an individual store for purposes of determining long-lived asset recoverability, management makes assumptions, incorporating local market conditions, about key store variables including sales growth rates, gross margin and operating expense. If economic conditions in the markets in which the Company conducts business remain weak or further deteriorate, or if other negative market conditions develop, the Company may experience additional impairment charges in the future for underperforming stores. These impairment charges are included in selling and administrative expense for the 39 weeks ended September 30, 2012 and October 2, 2011 in the interim unaudited condensed consolidated statements of operations.

**(4) Store Closing Costs**

The Company closed three underperforming stores in fiscal 2012, which will not be relocated. Two of those stores were closed in the second quarter of fiscal 2012 and the remaining store was closed in the third quarter of fiscal 2012. The store closing costs primarily included lease termination costs that expire in fiscal 2014. The following table summarizes the activity of the Company's store closing reserves:

|                               | Severance<br>Costs | Lease<br>Termination<br>Costs | Other<br>Associated<br>Costs | Total    |
|-------------------------------|--------------------|-------------------------------|------------------------------|----------|
|                               | (In thousands)     |                               |                              |          |
| Balance at January 1, 2012    | \$ 21              | \$ 1,032                      | \$ 121                       | \$ 1,174 |
| Store closing costs           |                    |                               |                              |          |
| Payments                      | (17)               | (152)                         | (119)                        | (288)    |
| Balance at September 30, 2012 | \$ 4               | \$ 880                        | \$ 2                         | \$ 886   |

The Company recorded \$0.7 million of expense related to the closure of two of these underperforming stores in the second quarter of fiscal 2012, and recorded an additional \$0.4 million of expense related to the closure of the third underperforming store in the third quarter of fiscal 2012. This expense is reflected as part of selling and administrative expense in the accompanying interim unaudited condensed consolidated statement of operations.

The current portion of accrued store closing costs is recorded in accrued expenses and the noncurrent portion is recorded in other long-term liabilities in the accompanying interim unaudited condensed consolidated balance sheet.

The Company expects to close an additional store in the fourth quarter of fiscal 2012. No costs associated with this store closing have been recognized during the 39 weeks ended September 30, 2012, and these costs are not expected to be material in the fourth quarter of fiscal 2012.

**BIG 5 SPORTING GOODS CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

**(5) Fair Value Measurements**

The carrying values of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate the fair values of these instruments due to their short-term nature. The carrying amount for borrowings under the revolving credit facility approximates fair value because of the variable market interest rate charged to the Company for these borrowings. The carrying values of certain assets subject to long-lived asset impairment are measured at fair value subsequent to their initial recognition.

**(6) Accrued Expenses**

Accrued expenses consist of the following:

|                             | September 30,<br>2012 | January 1,<br>2012 |
|-----------------------------|-----------------------|--------------------|
|                             | (In thousands)        |                    |
| Payroll and related expense | \$ 18,886             | \$ 19,691          |
| Occupancy costs             | 10,343                | 8,722              |
| Sales tax                   | 6,974                 | 9,235              |
| Income taxes payable        | 5,167                 |                    |
| Advertising                 | 3,701                 | 7,685              |
| Other                       | 15,814                | 17,214             |
| Accrued expenses            | \$ 60,885             | \$ 62,547          |

**(7) Long-Term Debt**

On October 18, 2010, the Company entered into a credit agreement (the Credit Agreement) with Wells Fargo Bank, National Association (Wells Fargo), as administrative agent, and a syndicate of other lenders. Initial borrowings under the Credit Agreement were used to, among other things, repay all of the Company's outstanding indebtedness under its prior financing agreement, at which time the prior financing agreement was terminated. On October 31, 2011, the Company amended certain provisions of its Credit Agreement.

The Credit Agreement provides for a revolving credit facility (the Credit Facility) with an aggregate committed availability of up to \$140.0 million, which amount may be increased at the Company's option up to a maximum of \$165.0 million. The Company may also request additional increases in aggregate availability, up to a maximum of \$200.0 million, in which case the existing lenders under the Credit Agreement will have the option to increase their commitments to accommodate the requested increase. If such existing lenders do not exercise that option, the Company may (with the consent of Wells Fargo, not to be unreasonably withheld) seek other lenders willing to provide such commitments. The Credit Facility includes a \$50.0 million sublimit for issuances of letters of credit and a \$20.0 million sublimit for swingline loans.

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**BIG 5 SPORTING GOODS CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

Obligations under the Credit Facility are secured by a general lien and perfected security interest in substantially all of the Company's assets. The Credit Agreement contains covenants that require the Company to maintain a fixed charge coverage ratio of not less than 1.0:1.0 in certain circumstances, and limit the Company's ability to, among other things, incur liens, incur additional indebtedness, transfer or dispose of assets, change the nature of the business, guarantee obligations, pay dividends or make other distributions or repurchase stock, and make advances, loans or investments.

The applicable interest rate on the Company's borrowings will be a function of the daily average, over the preceding fiscal quarter, of the excess of the Credit Facility over amounts borrowed (such amount being referred to as the "Average Daily Excess Availability"). Those loans designated as LIBO rate loans shall bear interest at a rate equal to the then applicable LIBO rate plus an applicable margin as shown in the table below. Those loans designated as base rate loans shall bear interest at a rate equal to the applicable margin for base rate loans (as shown below) plus the highest of (a) the Federal funds rate, as in effect from time to time, plus one-half of one percent (0.50%), (b) the LIBO rate, as adjusted to account for statutory reserves, plus one percent (1.00%), or (c) the rate of interest in effect for such day as publicly announced from time to time by Wells Fargo as its "prime rate." The applicable margin for all loans will be as set forth below as a function of Average Daily Excess Availability for the preceding fiscal quarter.

| Level | Average Daily Excess Availability     | LIBO Rate<br>Applicable<br>Margin | Base Rate<br>Applicable<br>Margin |
|-------|---------------------------------------|-----------------------------------|-----------------------------------|
| I     | Greater than or equal to \$70,000,000 | 1.50%                             | 0.50%                             |
| II    | Greater than or equal to \$40,000,000 | 1.75%                             | 0.75%                             |
| III   | Less than \$40,000,000                | 2.00%                             | 1.00%                             |

The amendment reduced the commitment fee assessed on the unused portion of the Credit Facility to 0.375% per annum.

The maturity date of the Credit Agreement, as amended, is October 31, 2016.

The Company had long-term revolving credit borrowings of \$52.6 million at September 30, 2012 and \$63.5 million at January 1, 2012. Total remaining borrowing availability, after subtracting letters of credit, was \$83.3 million and \$72.8 million as of September 30, 2012 and January 1, 2012, respectively.

**BIG 5 SPORTING GOODS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

**(8) Income Taxes**

Under the asset and liability method prescribed under ASC 740, *Income Taxes*, the Company recognizes deferred tax assets and liabilities for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. The realizability of deferred tax assets is assessed throughout the year and a valuation allowance is recorded if necessary to reduce net deferred tax assets to the amount more likely than not to be realized. As of September 30, 2012 and January 1, 2012, there was no valuation allowance as the deferred income tax assets were more likely than not to be realized.

The Company files a consolidated federal income tax return and files tax returns in various state and local jurisdictions. The statutes of limitations for consolidated federal income tax returns are open for fiscal years 2009 and after, and state and local income tax returns are open for fiscal years 2007 and after.

At September 30, 2012 and January 1, 2012, the Company had no unrecognized tax benefits that, if recognized, would affect the Company's effective income tax rate over the next 12 months. The Company's policy is to recognize interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expense. At September 30, 2012 and January 1, 2012, the Company had no accrued interest or penalties.



## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

**(9) Share-based Compensation**

At its discretion, the Company grants share option awards, nonvested share awards and nonvested share unit awards to certain employees, as defined by ASC 718, *Compensation - Stock Compensation*, under the Company's 2007 Equity and Performance Incentive Plan, as amended and restated on June 14, 2011 (the Plan), and accounts for its share-based compensation in accordance with ASC 718. The Company recognized \$0.4 million and \$1.3 million in share-based compensation expense for the 13 and 39 weeks ended September 30, 2012, respectively, compared to \$0.4 million and \$1.3 million for the 13 weeks and 39 weeks ended October 2, 2011, respectively.

*Share Option Awards*

Share option awards granted by the Company generally vest and become exercisable in four equal annual installments of 25% per year with a maximum life of ten years. The exercise price of the share option awards is equal to the quoted market price of the Company's common stock on the date of grant. In the 39 weeks ended September 30, 2012 and October 2, 2011, the Company granted 15,000 share option awards and 32,000 share option awards, respectively. The weighted-average grant-date fair value per option for share option awards granted in the 39 weeks ended September 30, 2012 and October 2, 2011 was \$2.12 and \$2.87, respectively.

The fair value of each share option award on the date of grant is estimated using the Black-Scholes method based on the following weighted-average assumptions:

|                         | 39 Weeks Ended        |                    |
|-------------------------|-----------------------|--------------------|
|                         | September 30,<br>2012 | October 2,<br>2011 |
| Risk-free interest rate | 1.2%                  | 2.1%               |
| Expected term           | 7.70 years            | 7.30 years         |
| Expected volatility     | 53.0%                 | 51.0%              |
| Expected dividend yield | 4.71%                 | 3.80%              |

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected term of the option award; the expected term represents the weighted-average period of time that option awards granted are expected to be outstanding giving consideration to vesting schedules and historical participant exercise behavior; the expected volatility is based upon historical volatility of the Company's common stock; and the expected dividend yield is based upon the Company's current dividend rate and future expectations.

As of September 30, 2012, there was \$0.3 million of total unrecognized compensation cost related to nonvested share option awards granted. That cost is expected to be recognized over a weighted-average period of 1.2 years.

## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

*Nonvested Share Awards and Nonvested Share Unit Awards*

Nonvested share awards and nonvested share unit awards granted by the Company vest from the date of grant in four equal annual installments of 25% per year with a maximum life of ten years. Nonvested share awards are delivered to the recipient upon their vesting. With respect to nonvested share unit awards, vested shares will be delivered to the recipient on the tenth business day of January following the year in which the recipient's service to the Company is terminated. The total fair value of nonvested share awards which vested during the 39 weeks ended September 30, 2012 and October 2, 2011 was \$0.8 million and \$0.8 million, respectively.

The Company granted 145,100 and 152,100 nonvested share awards in the 39 weeks ended September 30, 2012 and October 2, 2011, respectively. The weighted-average grant-date fair value per share of the Company's nonvested share awards granted in the 39 weeks ended September 30, 2012 and October 2, 2011 was \$7.79 and \$11.84, respectively.

The following table details the Company's nonvested share awards activity for the 39 weeks ended September 30, 2012:

|                               | Shares    | Weighted-Average Grant-Date Fair Value |
|-------------------------------|-----------|--|
| Balance at January 1, 2012    | 304,700   | \$ 13.03                               |
| Granted                       | 145,100   | 7.79                                   |
| Vested                        | (107,675) | 12.34                                  |
| Forfeited                     | (10,050)  | 11.57                                  |
| Balance at September 30, 2012 | 332,075   | \$ 11.01                               |

To satisfy employee minimum statutory tax withholding requirements for nonvested share awards that vest, the Company withholds and retires a portion of the vesting common shares, unless an employee elects to pay cash. In the 39 weeks ended September 30, 2012, the Company withheld 36,011 common shares with a total value of \$0.3 million. This amount is presented as a cash outflow from financing activities in the accompanying interim unaudited condensed consolidated statements of cash flows.

In the 39 weeks ended September 30, 2012 and October 2, 2011, the Company granted 12,000 and 9,000 nonvested share unit awards, respectively. The weighted-average grant-date fair value per share of the Company's nonvested share unit awards granted in the 39 weeks ended September 30, 2012 and October 2, 2011 was \$6.33 and \$8.26, respectively.

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**BIG 5 SPORTING GOODS CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(continued)**

The following table details the Company's nonvested share unit awards activity for the 39 weeks ended September 30, 2012:

|                                      | Units         | Weighted-Average<br>Grant-Date<br>Fair Value |
|--------------------------------------|---------------|--|
| Balance at January 1, 2012           | 9,000         | \$ 8.26                                      |
| Granted                              | 12,000        | 6.33   |
| Vested                               | (2,250)       | 8.26   |
| Forfeited                            |               |  |
| <b>Balance at September 30, 2012</b> | <b>18,750</b> | <b>\$ 7.02</b>                               |

As of September 30, 2012, there was \$2.8 million and \$0.1 million of total unrecognized compensation cost related to nonvested share awards and nonvested share unit awards, respectively. That cost is expected to be recognized over a weighted-average period of 2.6 years and 3.3 years for nonvested share awards and nonvested share unit awards, respectively.

The weighted-average grant-date fair value of nonvested share awards and nonvested share unit awards is the quoted market price of the Company's common stock on the date of grant, as shown in the tables above.

## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

**(10) Earnings Per Share**

The Company calculates earnings per share in accordance with ASC 260, *Earnings Per Share*, which requires a dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income by the weighted-average shares of common stock outstanding, reduced by shares repurchased and held in treasury, during the period. Diluted earnings per share represents basic earnings per share adjusted to include the potentially dilutive effect of outstanding share option awards, nonvested share awards and nonvested share unit awards.

The following table sets forth the computation of basic and diluted earnings per common share:

|  | 13 Weeks Ended                           |                    | 39 Weeks Ended        |                    |
|--|--|--------------------|-----------------------|--------------------|
|  | September 30,<br>2012                    | October 2,<br>2011 | September 30,<br>2012 | October 2,<br>2011 |
|  | (In thousands, except per share amounts) |                    |                       |                    |
| Net income   | \$ 8,169                                 | \$ 5,817           | \$ 10,883             | \$ 11,682          |
| Weighted-average shares of common stock outstanding:   |  |                    |                       |                    |
| Basic  | 21,325                                   | 21,689             | 21,413                | 21,660             |
| Dilutive effect of common stock equivalents arising from share option, nonvested share and nonvested share unit awards | 155                                      | 102                | 175                   | 214                |
| Diluted  | 21,480                                   | 21,791             | 21,588                | 21,874             |
| Basic earnings per share   | \$ 0.38                                  | \$ 0.27            | \$ 0.51               | \$ 0.54            |
| Diluted earnings per share   | \$ 0.38                                  | \$ 0.27            | \$ 0.50               | \$ 0.53            |

The computation of diluted earnings per share for the 13 weeks ended September 30, 2012, the 39 weeks ended September 30, 2012, the 13 weeks ended October 2, 2011 and the 39 weeks ended October 2, 2011 does not include share option awards in the amounts of 1,250,618, 1,281,455, 1,293,645 and 1,041,008 shares, respectively, that were outstanding and antidilutive (i.e., including such share option awards would result in higher earnings per share), since the exercise prices of these share option awards exceeded the average market price of the Company's common shares. Additionally, the computation of diluted earnings per share for the 13 weeks ended September 30, 2012, the 13 weeks ended October 2, 2011 and the 39 weeks ended October 2, 2011 does not include nonvested share awards and nonvested share unit awards in the amounts of 189,186, 289,621 and 109,471 shares, respectively, that were outstanding and antidilutive, since the grant date fair values of these nonvested share awards exceeded the average market price of the Company's common shares. No nonvested share awards and nonvested share unit awards were antidilutive for the 39 weeks ended September 30, 2012.

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**BIG 5 SPORTING GOODS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(continued)

**(11) Commitments and Contingencies**

The Company was served on the following dates with the following nine complaints, each of which was brought as a purported class action on behalf of persons who made purchases at the Company's stores in California using credit cards and were requested or required to provide personal identification information at the time of the transaction: (1) on February 22, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Maria Eugenia Saenz Valiente v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455049; (2) on February 22, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Scott Mossler v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455477; (3) on February 28, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Yelena Matatova v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455459; (4) on March 8, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Neal T. Wiener v. Big 5 Sporting Goods Corporation*, et al., Case No. BC456300; (5) on March 22, 2011, a complaint filed in the California Superior Court in the County of San Francisco, entitled *Donna Motta v. Big 5 Sporting Goods Corporation*, et al., Case No. CGC-11-509228; (6) on March 30, 2011, a complaint filed in the California Superior Court in the County of Alameda, entitled *Steve Holmes v. Big 5 Sporting Goods Corporation*, et al., Case No. RG11563123; (7) on March 30, 2011, a complaint filed in the California Superior Court in the County of San Francisco, entitled *Robin Nelson v. Big 5 Sporting Goods Corporation*, et al., Case No. CGC-11-508829; (8) on April 8, 2011, a complaint filed in the California Superior Court in the County of San Joaquin, entitled *Pamela B. Smith v. Big 5 Sporting Goods Corporation*, et al., Case No. 39-2011-00261014-CU-BT-STK; and (9) on May 31, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Deena Gabriel v. Big 5 Sporting Goods Corporation*, et al., Case No. BC462213. On June 16, 2011, the Judicial Council of California issued an Order Assigning Coordination Trial Judge designating the California Superior Court in the County of Los Angeles as having jurisdiction to coordinate and to hear all nine of the cases as Case No. JCCP4667. On October 21, 2011, the plaintiffs collectively filed a Consolidated Amended Complaint, alleging violations of the California Civil Code, negligence, invasion of privacy and unlawful intrusion. The plaintiffs allege, among other things, that customers making purchases with credit cards at the Company's stores in California were improperly requested to provide their zip code at the time of such purchases. The plaintiffs seek, on behalf of the class members, the following: statutory penalties; attorneys' fees; costs; restitution of property; disgorgement of profits; and injunctive relief. The Company intends to defend this litigation vigorously. Because this litigation remains in the preliminary stages and, among other things, discovery is still ongoing, the Company is not able to evaluate the likelihood of an unfavorable outcome in this litigation or to estimate a range of potential loss in the event of an unfavorable outcome in this litigation at the present time. If this litigation is resolved unfavorably to the Company, such litigation and the costs of defending it could have a material negative impact on the Company's results of operations or financial condition.

**BIG 5 SPORTING GOODS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(continued)**

The Company is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters is not expected to have a material adverse effect on the Company's results of operations or financial condition.

**(12) Subsequent Event**

In the fourth quarter of fiscal 2012, the Company's Board of Directors declared a quarterly cash dividend of \$0.075 per share of outstanding common stock, which will be paid on December 14, 2012 to stockholders of record as of November 30, 2012.

- 19 -

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of

Big 5 Sporting Goods Corporation

El Segundo, California

We have reviewed the accompanying condensed consolidated balance sheet of Big 5 Sporting Goods Corporation and subsidiaries (the Corporation ) as of September 30, 2012, and the related condensed consolidated statements of operations for the 13 and 39 weeks ended September 30, 2012 and October 2, 2011 and of cash flows for the 39 weeks ended September 30, 2012 and October 2, 2011. These interim financial statements are the responsibility of the Corporation's management.

We conducted our reviews 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 such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Big 5 Sporting Goods Corporation and subsidiaries as of January 1, 2012, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated February 29, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of January 1, 2012 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ DELOITTE & TOUCHE LLP

Los Angeles, California

November 2, 2012

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of the Big 5 Sporting Goods Corporation ( we , our , us ) financial condition and results of operations includes information with respect to our plans and strategies for our business and should be read in conjunction with our interim unaudited condensed consolidated financial statements and related notes ( Interim Financial Statements ) included herein and our consolidated financial statements and related notes, and *Management's Discussion and Analysis of Financial Condition and Results of Operations* contained in our Annual Report on Form 10-K for the fiscal year ended January 1, 2012.

### Overview

We are a leading sporting goods retailer in the western United States, operating 407 stores in 12 states under the name Big 5 Sporting Goods at September 30, 2012. We provide a full-line product offering in a traditional sporting goods store format that averages approximately 11,000 square feet. Our product mix includes athletic shoes, apparel and accessories, as well as a broad selection of outdoor and athletic equipment for team sports, fitness, camping, hunting, fishing, tennis, golf, snowboarding and roller sports.

### Executive Summary

Our improved operating results for the third quarter of fiscal 2012 compared to the third quarter of fiscal 2011 were mainly attributable to our higher sales level, including an increase in same store sales of 5.2%. We believe our higher sales primarily reflect favorable customer response to changes in our merchandise offering and new marketing initiatives along with the positive influence of more favorable weather this year. We also believe our operating results for the third quarter of fiscal 2012 and the third quarter of fiscal 2011 continue to reflect challenging macroeconomic conditions in our markets resulting primarily from the lingering effects of the economic recession.

Net sales for the third quarter of fiscal 2012 increased 7.3% to \$251.8 million compared to \$234.7 million for the third quarter of fiscal 2011. The increase in net sales was primarily attributable to an increase in same store sales of 5.2% as well as added sales from new stores, partially offset by lower closed store sales. The increase in net sales also reflected a favorable shift of certain Fourth of July holiday-related sales into the third quarter of fiscal 2012. Same store sales for a period reflect net sales from stores that operated throughout the period as well as the full corresponding prior year period.

Net income for the third quarter of fiscal 2012 increased to \$8.2 million, or \$0.38 per diluted share, compared to \$5.8 million, or \$0.27 per diluted share, for the third quarter of fiscal 2011. The increase in net income primarily reflected the effect of higher gross profit resulting from the increase in net sales and higher merchandise margins, partially offset by higher selling and administrative expense.



Gross profit as a percentage of net sales for the third quarter of fiscal 2012 increased by 50 basis points to 33.3%, primarily due to higher merchandise margins along with lower store occupancy and distribution costs as a percentage of net sales.

Selling and administrative expense for the third quarter of fiscal 2012 increased 4.3% to \$70.4 million compared to \$67.5 million for the third quarter of fiscal 2011, but decreased as a percentage of net sales to 27.9% for the third quarter of fiscal 2012 compared to 28.8% for the same period last year. The increase in selling and administrative expense was primarily attributable to added expense for the increased store count, higher employee benefit-related costs and a store closing-related charge.

Operating income for the third quarter of fiscal 2012 increased to \$13.5 million, or 5.4% of net sales, compared to \$9.5 million, or 4.0% of net sales, for the third quarter of fiscal 2011. The higher operating income primarily reflected the effect of higher gross profit resulting from the increase in net sales and higher merchandise margins, partially offset by higher selling and administrative expense.

### Results of Operations

The results of the interim periods are not necessarily indicative of results for the entire fiscal year.

#### 13 Weeks Ended September 30, 2012 Compared to 13 Weeks Ended October 2, 2011

The following table sets forth selected items from our interim unaudited condensed consolidated statements of operations by dollar and as a percentage of our net sales for the periods indicated:

|   | 13 Weeks Ended                     |        |                 |        |
|---|------------------------------------|--------|-----------------|--------|
|   | September 30, 2012                 |        | October 2, 2011 |        |
|   | (In thousands, except percentages) |        |                 |        |
| Net sales   | \$ 251,774                         | 100.0% | \$ 234,680      | 100.0% |
| Cost of sales <sup>(1)</sup>                      | 167,901                            | 66.7   | 157,691         | 67.2   |
| Gross profit                                      | 83,873                             | 33.3   | 76,989          | 32.8   |
| Selling and administrative expense <sup>(2)</sup> | 70,384                             | 27.9   | 67,484          | 28.8   |
| Operating income                                  | 13,489                             | 5.4    | 9,505           | 4.0    |
| Interest expense                                  | 469                                | 0.2    | 632             | 0.2    |
| Income before income taxes                        | 13,020                             | 5.2    | 8,873           | 3.8    |
| Income taxes                                      | 4,851                              | 1.9    | 3,056           | 1.3    |
| Net income  | \$ 8,169                           | 3.3%   | \$ 5,817        | 2.5%   |

<sup>(1)</sup> Cost of sales includes the cost of merchandise, net of discounts or allowances earned, freight, inventory reserves, buying, distribution center costs and store occupancy costs. Store occupancy costs include rent, amortization of leasehold improvements, common area maintenance, property taxes and insurance.

<sup>(2)</sup> Selling and administrative expense includes store-related expense, other than store occupancy costs, as well as advertising, depreciation and amortization, expense associated with operating our corporate headquarters and impairment charges.

*Net Sales.* Net sales increased by \$17.1 million, or 7.3%, to \$251.8 million in the 13 weeks ended September 30, 2012 from \$234.7 million in the comparable period last year. The change in net sales reflected the following:

Same store sales increased by \$12.0 million, or 5.2%, for the 13 weeks ended September 30, 2012, versus the comparable 13-week period in the prior year. We believe our higher sales primarily reflect favorable customer response to changes in our merchandise offering and new marketing initiatives along with the positive influence of more favorable weather this year. Same store sales for a period reflect net sales from stores that operated throughout the period as well as the full corresponding prior year period.

Added sales from new stores reflected the opening of 17 new stores since July 3, 2011, partially offset by lower closed store sales.

Customer traffic into our retail stores increased for the 13 weeks ended September 30, 2012 versus the comparable period last year.

Sales for the 13 weeks ended September 30, 2012 include the favorable impact of the calendar shift of the Fourth of July holiday further into the third quarter of fiscal 2012 compared to the 13-week period ended October 2, 2011, which resulted in certain Fourth of July holiday-related sales moving from the second quarter to the third quarter this year.

Store count at September 30, 2012 was 407 versus 398 at October 2, 2011. We opened two new stores and closed two stores, one of which was a relocation, in the 13 weeks ended September 30, 2012. We opened three new stores in the 13 weeks ended October 2, 2011. For fiscal 2012, we expect to open approximately 14 new stores, including three relocations, and close approximately six stores, including two relocations.

*Gross Profit.* Gross profit increased by \$6.9 million, or 8.9%, to \$83.9 million, or 33.3% of net sales, in the 13 weeks ended September 30, 2012 from \$77.0 million, or 32.8% of net sales, in the 13 weeks ended October 2, 2011. The change in gross profit was primarily attributable to the following:

Net sales increased \$17.1 million, or 7.3%, year over year in the third quarter of fiscal 2012.

Merchandise margins, which exclude buying, occupancy and distribution costs, increased 25 basis points versus the third quarter last year.

Store occupancy costs increased by \$0.8 million year over year in the third quarter of fiscal 2012, primarily reflecting the expense for new stores. Store occupancy costs decreased 24 basis points as a percentage of net sales.

Distribution costs increased \$0.7 million primarily from lower costs capitalized into inventory and higher distribution center labor and employee benefit-related costs. Distribution costs decreased 5 basis points as a percentage of net sales.

*Selling and Administrative Expense.* Selling and administrative expense increased by \$2.9 million to \$70.4 million in the 13 weeks ended September 30, 2012 from \$67.5 million in the same period last year. Selling and administrative expense as a percentage of net sales decreased 90 basis points to 27.9% in the 13 weeks ended September 30, 2012 from 28.8% in the same period last year. The increase in selling and administrative expense compared to the prior year was primarily attributable to added expense for new stores, higher employee benefit-related costs and a pre-tax charge of \$0.4 million related to a store closing, as discussed in Note 4 to the Interim Financial Statements included in Part I, Item 1, *Financial Statements*, of this Quarterly Report on Form 10-Q. Partially offsetting these expense increases were lower debit card fees compared to the third quarter last year.

*Interest Expense.* Interest expense decreased by \$0.2 million to \$0.5 million in the 13 weeks ended September 30, 2012 compared to the same period last year. This decrease in interest expense reflected a decrease in average debt levels of \$10.3 million to \$54.7 million in the third quarter of fiscal 2012 from \$65.0 million in the same period last year. Average interest rates declined 30 basis points, to 2.2% in the third quarter of fiscal 2012 from 2.5% in the same period last year, due mainly to lower applicable margins under our amended credit agreement.

*Income Taxes.* The provision for income taxes was \$4.9 million for the 13 weeks ended September 30, 2012 and \$3.1 million for the 13 weeks ended October 2, 2011. Our effective tax rate was 37.3% for the third quarter of fiscal 2012 compared with 34.4% for the third quarter of fiscal 2011. The increased effective tax rate for the third quarter of fiscal 2012 compared to the same period in fiscal 2011 primarily reflected lower income tax credits in the current year.

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39 Weeks Ended September 30, 2012 Compared to 39 Weeks Ended October 2, 2011

The following table sets forth selected items from our interim unaudited condensed consolidated statements of operations by dollar and as a percentage of our net sales for the periods indicated:

|   | 39 Weeks Ended                     |        |                 |        |
|---|------------------------------------|--------|-----------------|--------|
|   | September 30, 2012                 |        | October 2, 2011 |        |
|   | (In thousands, except percentages) |        |                 |        |
| Net sales   | \$ 696,882                         | 100.0% | \$ 675,411      | 100.0% |
| Cost of sales <sup>(1)</sup>                      | 472,505                            | 67.8   | 454,497         | 67.3   |
| Gross profit                                      | 224,377                            | 32.2   | 220,914         | 32.7   |
| Selling and administrative expense <sup>(2)</sup> | 205,560                            | 29.5   | 201,590         | 29.8   |
| Operating income                                  | 18,817                             | 2.7    | 19,324          | 2.9    |
| Interest expense                                  | 1,645                              | 0.2    | 1,838           | 0.3    |
| Income before income taxes                        | 17,172                             | 2.5    | 17,486          | 2.6    |
| Income taxes                                      | 6,289                              | 0.9    | 5,804           | 0.9    |
| Net income  | \$ 10,883                          | 1.6%   | \$ 11,682       | 1.7%   |

<sup>(1)</sup> Cost of sales includes the cost of merchandise, net of discounts or allowances earned, freight, inventory reserves, buying, distribution center costs and store occupancy costs. Store occupancy costs include rent, amortization of leasehold improvements, common area maintenance, property taxes and insurance.

<sup>(2)</sup> Selling and administrative expense includes store-related expense, other than store occupancy costs, as well as advertising, depreciation and amortization, expense associated with operating our corporate headquarters and impairment charges.

*Net Sales.* Net sales increased by \$21.5 million, or 3.2%, to \$696.9 million in the 39 weeks ended September 30, 2012 from \$675.4 million in the same period last year. The change in net sales reflected the following:

Added sales from new stores reflected the opening of 19 new stores since January 2, 2011, partially offset by lower closed store sales.

Same store sales increased by \$7.7 million, or 1.2%, in the 39 weeks ended September 30, 2012, versus the comparable 39-week period in the prior year, while also reflecting lower sales of winter merchandise as a result of unseasonably warm winter weather in the first quarter of fiscal 2012. Same store sales for a period reflect net sales from stores that operated throughout the period as well as the full corresponding prior year period.

Customer traffic into our retail stores decreased for the 39 weeks ended September 30, 2012 versus the comparable period last year. Store count at September 30, 2012 was 407 versus 398 at October 2, 2011. We opened six new stores, two of which were relocations, and closed five stores, two of which were relocations, in the 39 weeks ended September 30, 2012. We opened five new stores, two of which were relocations, and closed three stores related to 2010 relocations in the 39 weeks ended October 2, 2011. For fiscal 2012, we expect to open approximately 14 new stores, including three relocations, and close approximately six stores, including two relocations.

*Gross Profit.* Gross profit increased by \$3.5 million, or 1.6%, to \$224.4 million in the 39 weeks ended September 30, 2012 from \$220.9 million in the 39 weeks ended October 2, 2011. Gross profit decreased 50 basis points to 32.2% in the 39 weeks ended September 30, 2012 from 32.7% in the same period last year. The change in gross profit was primarily attributable to the following:

Net sales increased by \$21.5 million, or 3.2%, in the 39 weeks ended September 30, 2012 compared to the same period last year.

Merchandise margins, which exclude buying, occupancy and distribution costs, decreased 37 basis points year over year, primarily reflecting a significant sales mix shift away from higher margin winter product categories in the first quarter of fiscal 2012, combined with product cost inflation.

Store occupancy costs increased by \$2.1 million, or 4 basis points, year over year, primarily reflecting the expense for new stores.

Distribution costs increased \$1.4 million, or 7 basis points, primarily from lower costs capitalized into inventory and higher distribution center labor and employee benefit-related costs, partially offset by lower trucking expense.

*Selling and Administrative Expense.* Selling and administrative expense increased by \$4.0 million to \$205.6 million in the 39 weeks ended September 30, 2012 from \$201.6 million in the same period last year. Selling and administrative expense as a percentage of net sales decreased 30 basis points to 29.5% in the 39 weeks ended September 30, 2012 from 29.8% in the same period last year. The increase in selling and administrative expense compared to the prior year was primarily attributable to added expense for new stores, higher employee benefit-related costs, higher than normal store public liability claims-related costs and a pre-tax charge of \$1.1 million related to store closing costs, as discussed in Note 4 to the Interim Financial Statements included in Part I, Item 1, *Financial Statements*, of this Quarterly Report on Form 10-Q. Offsetting these expense increases were lower debit card fees and advertising expense, along with reduced impairment charges related to certain underperforming stores, compared to the prior year.

*Interest Expense.* Interest expense decreased by \$0.2 million to \$1.6 million in the 39 weeks ended September 30, 2012 compared to the same period last year. This decrease in interest expense reflects a decrease in average interest rates of 30 basis points, to 2.3% in the 39 weeks ended September 30, 2012 from 2.6% in the same period last year, due mainly to lower applicable margins under our amended credit agreement. The impact of decreased average interest rates was offset by an increase in average debt levels of \$3.9 million to \$64.0 million in the 39 weeks ended September 30, 2012 from \$60.1 million in the same period last year.

*Income Taxes.* The provision for income taxes was \$6.3 million for the 39 weeks ended September 30, 2012 and \$5.8 million for the 39 weeks ended October 2, 2011. Our effective tax rate was 36.6% for the 39 weeks ended September 30, 2012 compared with 33.2% for the same period last year. Our higher effective tax rate for the 39 weeks ended September 30, 2012 compared to the same period in fiscal 2011 primarily reflected lower income tax credits in the current year.

## Liquidity and Capital Resources

Our principal liquidity requirements are for working capital, capital expenditures and cash dividends. We fund our liquidity requirements primarily through cash and cash equivalents on hand, cash flows from operations and borrowings from our revolving credit facility. We believe our cash and cash equivalents on hand, future cash flows from operations and borrowings from our revolving credit facility will be sufficient to fund our cash requirements for at least the next 12 months. There is no assurance, however, that we will be able to generate sufficient cash flows from operations or maintain our ability to borrow under our revolving credit facility.

We ended the third quarter of fiscal 2012 with \$5.0 million of cash and cash equivalents compared with \$4.7 million at the end of the same period in fiscal 2011. Our cash flows from operating, investing and financing activities are summarized as follows:

|  | 39 Weeks Ended        |                    |
|--|-----------------------|--------------------|
|  | September 30,<br>2012 | October 2,<br>2011 |
|  | (In thousands)        |                    |
| Net cash provided by (used in):                      |                       |                    |
| Operating activities                                 | \$ 28,529             | \$ (11,570)        |
| Investing activities                                 | (7,025)               | (6,814)            |
| Financing activities                                 | (21,407)              | 17,487             |
| Net increase (decrease) in cash and cash equivalents | \$ 97                 | \$ (897)           |

*Operating Activities.* Net cash provided by operating activities for the 39 weeks ended September 30, 2012 was \$28.5 million, and net cash used in operating activities for the 39 weeks ended October 2, 2011 was \$11.6 million. The increase in cash flow from operating activities for the 39 weeks ended September 30, 2012 compared to the same period last year primarily reflects an increase in

accounts payable and lower inventory year over year. The increase in accounts payable during the first nine months of fiscal 2012 over the first nine months of the prior year was due primarily to the timing of inventory purchases. Inventory purchases were lower in the fourth quarter of fiscal 2011 compared to the fourth quarter of fiscal 2010, which resulted in a lower accounts payable balance at the end of fiscal 2011. The reduced inventory during the first nine months of fiscal 2012 compared to the first nine months of the prior year was related primarily to improved sales in fiscal 2012. Also, for the first nine months of fiscal 2011, we strategically increased inventory levels to add certain new products and purchased inventory earlier in the year to mitigate the impact of product cost inflation and potential delivery delays.

*Investing Activities.* Net cash used in investing activities for the 39 weeks ended September 30, 2012 and October 2, 2011 was \$7.0 million and \$6.8 million, respectively. Capital expenditures, excluding non-cash property and equipment acquisitions, for the 39 weeks ended September 30, 2012 and October 2, 2011 were \$7.3 million and \$7.8 million, respectively. We received proceeds of \$0.3 million and \$0.5 million in the 39 weeks ended September 30, 2012 and October 2, 2011, respectively, as part of a local utility rebate program related to the implementation of a green energy system at our distribution center. Additionally, we received proceeds of \$0.5 million from the sale of owned real property in the 39 weeks ended October 2, 2011.

*Financing Activities.* Net cash used in financing activities for the 39 weeks ended September 30, 2012 was \$21.4 million, and net cash provided by financing activities for the 39 weeks ended October 2, 2011 was \$17.5 million. In the first nine months of fiscal 2012, net cash was used primarily to pay down borrowings under our revolving credit facility, pay dividends and repurchase stock. In the first nine months of fiscal 2011, net cash was provided primarily from increased borrowings under our revolving credit facility, offset by cash used to pay dividends.

As of September 30, 2012, we had revolving credit borrowings of \$52.6 million and letter of credit commitments of \$4.1 million outstanding. These balances compare to revolving credit borrowings of \$63.5 million and letter of credit commitments of \$3.7 million outstanding as of January 1, 2012 and revolving credit borrowings of \$69.1 million and letter of credit commitments of \$3.5 million outstanding as of October 2, 2011. The decrease in revolving credit borrowings at the end of the third quarter of fiscal 2012 compared to the same period last year primarily reflects our ability to pay down debt using cash flow generated from operating activities.

In fiscal 2011 and the first three quarters of fiscal 2012, our Board of Directors declared quarterly cash dividends of \$0.075 per share of outstanding common stock, for an annual rate of \$0.30 per share. In the fourth quarter of fiscal 2012, our Board of Directors also declared a quarterly cash dividend of \$0.075 per share of outstanding common stock, which will be paid on December 14, 2012 to stockholders of record as of November 30, 2012.

In the fourth quarter of fiscal 2011, we resumed our share repurchase activity under our previously announced program, and in the first nine months of fiscal 2012 we repurchased 408,991 shares of our common stock for \$3.2 million. Since the inception of our initial share repurchase program in May 2006 through September 30, 2012, we have repurchased a total of 1,887,626 shares for \$25.0 million, leaving a total of \$10.0 million available for share repurchases under our current share repurchase program.

*Credit Agreement.* On October 18, 2010, we entered into a new credit agreement (the *Credit Agreement*) with Wells Fargo Bank, National Association ( *Wells Fargo* ), as administrative agent, and a syndicate of other lenders. Initial borrowings under the *Credit Agreement* on October 18, 2010 were used to, among other things, repay all of our outstanding indebtedness under our prior financing agreement, at which time the prior financing agreement was terminated. As further discussed below, the *Credit Agreement* was amended on October 31, 2011.

The *Credit Agreement* provides for a revolving credit facility (the *Credit Facility*) with an aggregate committed availability of up to \$140.0 million, which amount may be increased at our option up to a maximum of \$165.0 million. We may also request additional increases in aggregate availability, up to a maximum of \$200.0 million, in which case the existing lenders under the *Credit*

Agreement will have the option to increase their commitments to accommodate the requested increase. If such existing lenders do not exercise that option, we may (with the consent of Wells Fargo, not to be unreasonably withheld) seek other lenders willing to provide such commitments. The Credit Facility includes a \$50.0 million sublimit for issuances of letters of credit and a \$20.0 million sublimit for swingline loans. As of September 30, 2012 and January 1, 2012, our total remaining borrowing availability under the Credit Agreement, after subtracting letters of credit, was \$83.3 million and \$72.8 million, respectively.

We may borrow under the Credit Facility from time to time, provided the amounts outstanding will not exceed the lesser of the then aggregate availability (as discussed above) and the Borrowing Base (such lesser amount being referred to as the Loan Cap). The Borrowing Base generally is comprised of the sum, at the time of calculation of (a) 90.00% of our eligible credit card accounts receivable; plus (b)(i) during the period of September 15 through December 15 of each year, the cost of our eligible inventory, net of inventory reserves, multiplied by 90.00% of the appraised net orderly liquidation value of eligible inventory (expressed as a percentage of the cost of eligible inventory); and (ii) at all other times, the cost of our eligible inventory, net of inventory reserves, multiplied by 85.00% of the appraised net orderly liquidation value of eligible inventory (expressed as a percentage of the cost of eligible inventory); plus (c) the lesser of (i) the cost of our eligible in-transit inventory, net of inventory reserves, multiplied by 85.00% of the appraised net orderly liquidation value of our eligible in-transit inventory (expressed as a percentage of the cost of eligible in-transit inventory), or (ii) \$10.0 million, minus (d) certain reserves established by Wells Fargo in its role as the Administrative Agent in its reasonable discretion.

Generally, we may designate specific borrowings under the Credit Facility as either base rate loans or LIBO rate loans. In each case, the applicable interest rate was a function of the daily average, over the preceding fiscal quarter, of the excess of the Loan Cap over amounts outstanding under the Credit Facility (such amount being referred to as the Average Daily Excess Availability). Those loans designated as LIBO rate loans shall bear interest at a rate equal to the then applicable LIBO rate plus an applicable margin as shown in the table below. Those loans designated as base rate loans shall bear interest at a rate equal to the applicable margin for base rate loans (as shown below) plus the highest of (a) the Federal funds rate, as in effect from time to time, plus one-half of one percent (0.50%), (b) the LIBO rate, as adjusted to account for statutory reserves, plus one percent (1.00%), or (c) the rate of interest in effect for such day as publicly announced from time to time by Wells Fargo as its prime rate. Prior to the amendment of the Credit Agreement dated October 31, 2011 discussed below, the applicable margin for all loans was as set forth below as a function of Average Daily Excess Availability for the preceding fiscal quarter.

| Level | Average Daily Excess Availability         | LIBO Rate<br>Applicable<br>Margin | Base Rate<br>Applicable<br>Margin |
|-------|---|-----------------------------------|-----------------------------------|
| I     | Greater than 50% of the Loan Cap          | 2.00%                             | 1.00%                             |
| II    | Less than or equal to 50% of the Loan Cap | 2.25%                             | 1.25%                             |



On October 31, 2011, we entered into a First Amendment to Credit Agreement and amended certain provisions of our Credit Agreement. Following the Amendment, the applicable margin for all loans is as set forth below as a function of Average Daily Excess Availability for the preceding fiscal quarter.

| Level | Average Daily Excess Availability     | LIBO Rate<br>Applicable<br>Margin | Base Rate<br>Applicable<br>Margin |
|-------|---------------------------------------|-----------------------------------|-----------------------------------|
| I     | Greater than or equal to \$70,000,000 | 1.50%                             | 0.50%                             |
| II    | Greater than or equal to \$40,000,000 | 1.75%                             | 0.75%                             |
| III   | Less than \$40,000,000                | 2.00%                             | 1.00%                             |

As amended the Credit Agreement provides for a commitment fee to be assessed on the unused portion of the Credit Facility of 0.375% per annum.

Obligations under the Credit Facility are secured by a general lien and perfected security interest in substantially all of our assets. Our Credit Agreement contains covenants that require us to maintain a fixed charge coverage ratio of not less than 1.0:1.0 in certain circumstances, and limit our ability to, among other things, incur liens, incur additional indebtedness, transfer or dispose of assets, change the nature of the business, guarantee obligations, pay dividends or make other distributions or repurchase stock, and make advances, loans or investments. We may declare or pay cash dividends or repurchase stock only if, among other things, no default or event of default then exists or would arise from such dividend or repurchase of stock and, after giving effect to such dividend or repurchase, certain availability and/or fixed charge coverage ratio requirements are satisfied. The Credit Agreement contains customary events of default, including, without limitation, failure to pay when due principal amounts with respect to the Credit Facility, failure to pay any interest or other amounts under the Credit Facility for five days after becoming due, failure to comply with certain agreements or covenants contained in the Credit Agreement, failure to satisfy certain judgments against us, failure to pay when due (or any other default which does or may lead to the acceleration of) certain other material indebtedness in principal amount in excess of \$5.0 million, and certain insolvency and bankruptcy events.

The maturity date of the Credit Agreement, as amended, is October 31, 2016.

*Future Capital Requirements.* We had cash on hand of \$5.0 million as of September 30, 2012. We expect capital expenditures for the fourth quarter of fiscal 2012, excluding non-cash property and equipment acquisitions, to range from approximately \$4.0 million to \$6.0 million, primarily to fund the opening of new stores, store-related remodeling, distribution center equipment and computer hardware and software purchases. We expect our cash requirements related to closed stores in the fourth quarter of fiscal 2012 to be approximately \$0.2 million. For fiscal 2012, we expect to open approximately 14 new stores, including three relocations, and close approximately six stores, including two relocations.

In fiscal 2011 and the first three quarters of fiscal 2012, our Board of Directors declared and paid quarterly cash dividends of \$0.075 per share of outstanding common stock, for an annual rate of \$0.30 per share. For the fourth quarter of fiscal 2012, our Board of Directors also declared a quarterly cash dividend of \$0.075 per share of outstanding common stock, which will be paid on December 14, 2012 to stockholders of record as of November 30, 2012.

As of September 30, 2012, a total of \$10.0 million remained available for share repurchases under our share repurchase program. We consider several factors in determining when and if we make share repurchases including, among other things, our alternative cash requirements, business conditions and the market price of our stock.

We believe we will be able to fund our cash requirements, for at least the next 12 months, from cash and cash equivalents on hand, operating cash flows and borrowings from our revolving credit facility. However, our ability to satisfy our cash requirements depends upon our future performance, which in turn is subject to general economic conditions and regional risks, and to financial, business and other factors affecting our operations, including factors beyond our control. There is no assurance that we will be able to generate sufficient cash flow or that we will be able to maintain our ability to borrow under our revolving credit facility.

If we are unable to generate sufficient cash flow from operations to meet our obligations and commitments, or if we are unable to maintain our ability to borrow sufficient amounts under our Credit Agreement, we will be required to refinance or restructure our indebtedness or raise additional debt or equity capital. Additionally, we may be required to sell material assets or operations, suspend or reduce dividend payments or delay or forego expansion opportunities. We might not be able to implement successful alternative strategies on satisfactory terms, if at all.

*Off-Balance Sheet Arrangements and Contractual Obligations.* Our material off-balance sheet arrangements are operating lease obligations and letters of credit. We excluded these items from the balance sheet in accordance with accounting principles generally accepted in the United States of America.

Operating lease commitments consist principally of leases for our retail store facilities, distribution center and corporate office. These leases frequently include options which permit us to extend the terms beyond the initial fixed lease term. With respect to most of those leases, we intend to renegotiate those leases as they expire.

Our material contractual obligations include capital lease obligations, borrowings under our Credit Facility, certain occupancy costs related to our leased properties and other liabilities. Capital lease obligations, which include imputed interest, consist principally of leases for some of our distribution center delivery tractors, management information systems hardware and point-of-sale equipment for our stores. Our Credit Facility debt fluctuates daily depending on operating, investing and financing cash flows. Occupancy costs include estimated property maintenance fees and property taxes for our stores, distribution center and corporate headquarters. Other liabilities consist principally of actuarially-determined reserve estimates related to self-insurance liabilities, a contractual obligation for the surviving spouse of Robert W. Miller, our co-founder, and asset retirement obligations related to the removal of leasehold improvements for certain stores upon termination of their leases.

Issued and outstanding letters of credit were \$4.1 million at September 30, 2012, and were related primarily to securing insurance program liabilities.

Included in the *Liquidity and Capital Resources* section of Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, of our Annual Report on Form 10-K for the fiscal year ended January 1, 2012, is a discussion of our future obligations and commitments as of January 1, 2012. In the 39 weeks ended September 30, 2012, our revolving credit borrowings decreased by \$10.9 million from the end of fiscal 2011. We entered into new operating lease agreements in relation to our business operations during the 39 weeks ended September 30, 2012. We do not believe that these operating leases or the decrease in our revolving credit borrowings would materially impact our contractual obligations or commitments presented as of January 1, 2012.

In the ordinary course of business, we enter into arrangements with vendors to purchase merchandise in advance of expected delivery. Because most of these purchase orders do not contain any termination payments or other penalties if cancelled, they are not included as outstanding contractual obligations.

#### **Critical Accounting Estimates**

As discussed in Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, of our Annual Report on Form 10-K for the fiscal year ended January 1, 2012, we consider our estimates on inventory valuation, long-lived assets and self-insurance reserves to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements. There have been no significant changes to these estimates in the 39 weeks ended September 30, 2012.

#### **Seasonality and Impact of Inflation**

We experience seasonal fluctuations in our net sales and operating results. In the fourth fiscal quarter, which includes the holiday selling season, we experience normally higher purchase volumes and increased expense for staffing and advertising. Seasonality influences our buying patterns which directly impacts our merchandise and accounts payable levels and cash flows. We purchase merchandise for seasonal activities in advance of a season. If we miscalculate the demand for our products generally or for our product mix during the fourth fiscal quarter, our net sales can decline, which can harm our financial performance. A shortfall from expected fourth fiscal quarter net sales can negatively impact our annual operating results, as occurred in fiscal 2011.

In fiscal 2011, and diminishing in fiscal 2012, we experienced increasing inflation in the purchase cost, including transportation cost, of certain products. We are evolving our product mix to include more branded merchandise that we believe will give us added flexibility to adjust selling prices for purchase cost increases. If we are unable to adjust our selling prices for purchase cost increases then our merchandise margins will decline, which will adversely impact our operating results. Our lower merchandise margins for the 39 weeks ended September 30, 2012 compared to the same period last year partially reflected purchase cost increases.

### Recently Issued Accounting Updates

See Note 2 to the Interim Financial Statements included in Part I, Item 1, *Financial Statements*, of this Quarterly Report on Form 10-Q.

### Forward-Looking Statements

This document includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to, among other things, our financial condition, our results of operations, our growth strategy and the business of our company generally. In some cases, you can identify such statements by terminology such as may, could, project, estimate, potential, continue, should, expects, plans, anticipates, believes, intends or other such terminology. These forward-looking statements involve unknown risks, uncertainties and other factors that may cause our actual results in future periods to differ materially from forecasted results. These risks and uncertainties include, among other things, continued or worsening weakness in the consumer spending environment and the U.S. financial and credit markets, fluctuations in consumer holiday spending patterns, the competitive environment in the sporting goods industry in general and in our specific market areas, inflation, product availability and growth opportunities, seasonal fluctuations, weather conditions, changes in cost of goods, operating expense fluctuations, litigation risks, disruption in product flow, changes in interest rates, credit availability, higher costs associated with sources of credit resulting from uncertainty in financial markets and economic conditions in general. Those and other risks and uncertainties are more fully described in Part II, Item 1A, *Risk Factors*, in this report and in Part I, Item 1A, *Risk Factors*, in our Annual Report on Form 10-K and other filings with the United States Securities and Exchange Commission. We caution that the risk factors set forth in this report are not exclusive. In addition, we conduct our business in a highly competitive and rapidly changing environment. Accordingly, new risk factors may arise. It is not possible for management to predict all such risk factors, nor to assess the impact of all such risk factors on our business or the extent to which any individual risk factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. We undertake no obligation to revise or update any forward-looking statement that may be made from time to time by us or on our behalf.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are subject to risks resulting from interest rate fluctuations since interest on our borrowings under our Credit Facility is based on variable rates. We enter into borrowings under our Credit Facility principally for working capital, capital expenditures and general corporate purposes. We routinely evaluate the best use of our cash and cash equivalents on hand and manage financial statement exposure to interest rate fluctuations by managing our level of indebtedness and the interest base rate options on such indebtedness. We do not utilize derivative instruments and do not engage in foreign currency transactions or hedging activities to manage our interest rate risk. If the interest rate on our debt was to change 1.0% as compared to the rate at September 30, 2012, our interest expense would change approximately \$0.5 million on an annual basis based on the outstanding balance of our borrowings under our Credit Facility at September 30, 2012.

Inflationary factors and changes in foreign currency rates can increase the purchase cost of our products. If we are unable to adjust our selling prices for purchase cost increases then our merchandise margins will decline, which will adversely impact our operating results. We are evolving our product mix to include more branded merchandise that we believe will give us added flexibility to adjust selling prices for purchase cost increases. All of our stores are located in the United States, and all imported merchandise is purchased in U.S. dollars.

### **Item 4. Controls and Procedures**

#### **Evaluation of Disclosure Controls and Procedures**

We conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this report. Based on such evaluation, our CEO and CFO have concluded that, as of the end of such period, our disclosure controls and procedures are effective, at a reasonable assurance level, in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act and are effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

#### **Changes in Internal Control Over Financial Reporting**

During the fiscal quarter ended September 30, 2012, no changes occurred with respect to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

The Company was served on the following dates with the following nine complaints, each of which was brought as a purported class action on behalf of persons who made purchases at the Company's stores in California using credit cards and were requested or required to provide personal identification information at the time of the transaction: (1) on February 22, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Maria Eugenia Saenz Valiente v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455049; (2) on February 22, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Scott Mossler v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455477; (3) on February 28, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Yelena Matatova v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455459; (4) on March 8, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Neal T. Wiener v. Big 5 Sporting Goods Corporation*, et al., Case No. BC456300; (5) on March 22, 2011, a complaint filed in the California Superior Court in the County of San Francisco, entitled *Donna Motta v. Big 5 Sporting Goods Corporation*, et al., Case No. CGC-11-509228; (6) on March 30, 2011, a complaint filed in the California Superior Court in the County of Alameda, entitled *Steve Holmes v. Big 5 Sporting Goods Corporation*, et al., Case No. RG11563123; (7) on March 30, 2011, a complaint filed in the California Superior Court in the County of San Francisco, entitled *Robin Nelson v. Big 5 Sporting Goods Corporation*, et al., Case No. CGC-11-508829; (8) on April 8, 2011, a complaint filed in the California Superior Court in the County of San Joaquin, entitled *Pamela B. Smith v. Big 5 Sporting Goods Corporation*, et al., Case No. 39-2011-00261014-CU-BT-STK; and (9) on May 31, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Deena Gabriel v. Big 5 Sporting Goods Corporation*, et al., Case No. BC462213. On June 16, 2011, the Judicial Council of California issued an Order Assigning Coordination Trial Judge designating the California Superior Court in the County of Los Angeles as having jurisdiction to coordinate and to hear all nine of the cases as Case No. JCCP4667. On October 21, 2011, the plaintiffs collectively filed a Consolidated Amended Complaint, alleging violations of the California Civil Code, negligence, invasion of privacy and unlawful intrusion. The plaintiffs allege, among other things, that customers making purchases with credit cards at the Company's stores in California were improperly requested to provide their zip code at the time of such purchases. The plaintiffs seek, on behalf of the class members, the following: statutory penalties; attorneys' fees; costs; restitution of property; disgorgement of profits; and injunctive relief. The Company intends to defend this litigation vigorously. Because this litigation remains in the preliminary stages and, among other things, discovery is still ongoing, the Company is not able to evaluate the likelihood of an unfavorable outcome in this litigation or to estimate a range of potential loss in the event of an unfavorable outcome in this litigation at the present time. If this litigation is resolved unfavorably to the Company, such litigation and the costs of defending it could have a material negative impact on the Company's results of operations or financial condition.

The Company is involved in various other claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters is not expected to have a material adverse effect on the Company's results of operations or financial condition.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors identified in Part I, Item 1A, *Risk Factors*, of the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2012.

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

The following tabular summary reflects the Company's repurchase activity during the fiscal quarter ended September 30, 2012:

**ISSUER PURCHASES OF EQUITY SECURITIES <sup>(1) (2)</sup>**

| <i>Fiscal Period</i>     | <i>Total<br/>Number of<br/>Shares<br/>Purchased</i> | <i>Average<br/>Price Paid<br/>per Share</i> | <i>Total<br/>Number of<br/>Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</i> | <i>Maximum<br/>Number (or<br/>Approximate<br/>Dollar Value)<br/>of Shares that<br/>May Yet Be<br/>Purchased<br/>Under the<br/>Plans or<br/>Programs <sup>(3)</sup></i> |
|--------------------------|---|---|---|--|
| July 2 - July 29         |   |   |   | \$ 10,900,000  |
| July 30 - August 26      | 52,900  | \$ 7.78                                     | 52,900  | \$ 10,489,000  |
| August 27 - September 30 | 52,200  | \$ 8.78                                     | 52,200  | \$ 10,031,000  |
| Total                    | 105,100   |   | 105,100   | \$ 10,031,000  |

<sup>(1)</sup> All shares were purchased under the Company's current share repurchase program, which was announced on November 1, 2007 and authorizes the repurchase of the Company's common stock totaling \$20.0 million. Under the authorization, the Company may purchase shares from time to time in the open market or in privately negotiated transactions in compliance with the applicable rules and regulations of the SEC. However, the timing and amount of such purchases, if any, would be at the discretion of management and would depend upon market conditions and other considerations. Through September 30, 2012, the Company has repurchased 1,150,883 shares of its common stock for \$10.0 million, and a total of \$10.0 million remained available for share repurchases under the current authorization. Since the inception of its initial share repurchase program in May 2006 through September 30, 2012, the Company has repurchased a total of 1,887,626 shares for \$25.0 million.

<sup>(2)</sup> The Company's dividends and stock repurchases are generally funded by distributions from its subsidiary, Big 5 Corp. The Company's Credit Agreement contains covenants that require it to maintain a fixed charge coverage ratio of not less than 1.0:1.0 in certain circumstances, and limit the ability to, among other things, pay dividends or repurchase stock. The Company may declare or pay cash dividends or repurchase stock only if, among other things, no default or event of default then exists or would arise from such dividend or repurchase of stock and, after giving effect to such dividend or repurchase, certain availability and/or fixed charge coverage ratio requirements are satisfied. See Part I, Item 2, *Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources*, for a further discussion of the Credit Agreement.

<sup>(3)</sup> This amount reflects the dollar value of shares remaining available to repurchase under previously announced plans.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

During the third quarter of fiscal 2012, the Company commenced negotiations on new collective bargaining agreements with General Teamsters, Aerospace and Allied Employees, Warehousemen, Drivers, Construction, Rock and Sand; Airline Employees, Local Union No. 986, affiliated with the International Brotherhood of Teamsters ( Local 986 ), representing certain hourly employees in the Company's distribution center and select stores. The current collective bargaining agreements expired on August 31, 2012. In October 2012, the Company completed negotiation of a new five-year collective bargaining agreement with Local 986 for distribution center employees, retroactive to September 1, 2012 and expiring on August 31, 2017, while negotiations remain ongoing for the store collective bargaining agreement. Pending negotiations, the Company has agreed with Local 986 to extend the existing agreement covering store employees, subject to termination by either party on ten (10) days' written notice.



**Item 6. Exhibits**

## (a) Exhibits

| <b>Exhibit Number</b> | <b>Description of Document</b>  |
|-----------------------|---|
| 15.1                  | Independent Auditors Awareness Letter Regarding Interim Financial Statements. |
| 31.1                  | Rule 13a-14(a) Certification of Chief Executive Officer.                      |
| 31.2                  | Rule 13a-14(a) Certification of Chief Financial Officer.                      |
| 32.1                  | Section 1350 Certification of Chief Executive Officer.                        |
| 32.2                  | Section 1350 Certification of Chief Financial Officer.                        |
| 101.INS               | XBRL Instance Document.   |
| 101.SCH               | XBRL Taxonomy Extension Schema Document.                                      |
| 101.CAL               | XBRL Taxonomy Calculation Linkbase Document.                                  |
| 101.PRE               | XBRL Taxonomy Presentation Linkbase Document.                                 |
| 101.LAB               | XBRL Taxonomy Label Linkbase Document.  |
| 101.DEF               | XBRL Taxonomy Definition Linkbase Document.                                   |

Attached as Exhibits 101 to this report are the following financial statements from the Company's Quarterly Report on Form 10-Q for the third quarter ended September 30, 2012 formatted in XBRL ( eXtensible Business Reporting Language ): (i) the Unaudited Condensed Consolidated Balance Sheets, (ii) the Unaudited Condensed Consolidated Statements of Operations, (iii) the Unaudited Condensed Consolidated Statements of Cash Flows, and (iv) related notes to these unaudited condensed consolidated financial statements.

The XBRL related information in Exhibits 101 to this Quarterly Report on Form 10-Q shall not be deemed filed or a part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, and is not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of those sections.

**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.

**BIG 5 SPORTING GOODS CORPORATION,**  
a Delaware corporation

Date: November 2, 2012

By: */s/ Steven G. Miller*  
*Steven G. Miller*  
*Chairman of the Board of Directors,*  
  
*President and Chief Executive Officer*

Date: November 2, 2012

By: */s/ Barry D. Emerson*  
*Barry D. Emerson*  
*Senior Vice President,*  
  
*Chief Financial Officer and Treasurer*  
  
*(Principal Financial and*  
  
*Accounting Officer)*