BIG 5 SPORTING GOODS Corp
Form 10-Q
August 02, 2017

## 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 July 2, 2017
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from $\qquad$ to $\qquad$
Commission file number: 000-49850

## BIG 5 SPORTING GOODS CORPORATION

(Exact name of registrant as specified in its charter)

| Delaware <br> (State or Other Jurisdiction of Incorporation or Organization) | $95-4388794$ <br> (I.R.S. Employer Identification No.) |
| :--- | :--- |
| 2525 East El Segundo Boulevard |  |
| El Segundo, California | 90245 |
| (Address of Principal Executive Offices) | (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 |  |  |
| Emerging growth company | (Do not check if a smaller reporting company) | Smaller reporting company |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule $12 \mathrm{~b}-2$ of the Exchange Act). Yes No

There were $21,872,545$ shares of common stock, with a par value of $\$ 0.01$ per share outstanding as of July $25,2017$.

BIG 5 SPORTING GOODS CORPORATION
INDEX
Page
PART I - FINANCIAL INFORMATION
Item 1 Financial Statements ..... 3
Unaudited Condensed Consolidated Balance Sheets as of July 2. 2017 and January 1, 2017 ..... 3
Unaudited Condensed Consolidated Statements of Operations for the Thirteen and Twenty-Six Weeks Ended July 2, 2017 and July 3, 2016 ..... 4
Unaudited Condensed Consolidated Statements of Stockholders' Equity for the Twenty-Six Weeks EndedJuly 2, 2017 and July 3, 20165
Unaudited Condensed Consolidated Statements of Cash Flows for the Twenty-Six Weeks Ended July 2. 2017 and July 3. 2016 ..... 6
Notes to Unaudited Condensed Consolidated Financial Statements ..... 7
Report of Independent Registered Public Accounting Firm ..... 16
Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations ..... 17
Item 3 Quantitative and Qualitative Disclosures About Market Risk ..... 26
Item 4 Controls and Procedures ..... 26
PART II - OTHER INFORMATION
Item 1 Legal Proceedings ..... 27
Item
1A Risk Factors ..... 27
Item 2 Unregistered Sales of Equity Securities and Use of Proceeds ..... 27
Item 3 Defaults Upon Senior Securities ..... 27
Item 4 Mine Safety Disclosures ..... 27
Item 5 Other Information ..... 28
Item 6 Exhibits ..... 28
SIGNATURES ..... 29

## PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

## BIG 5 SPORTING GOODS CORPORATION

## UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

|  | July 2, | January $1,$ |
| :---: | :---: | :---: |
|  | 2017 | 2017 |
| ASSETS |  |  |
| Current assets: |  |  |
| Cash | \$6,628 | \$7,895 |
| Accounts receivable, net of allowances of \$40 and \$42, respectively | 12,125 | 12,200 |
| Merchandise inventories, net | 328,716 | 294,319 |
| Prepaid expenses | 11,531 | 10,085 |
| Total current assets | 359,000 | 324,499 |
| Property and equipment, net | 77,438 | 78,420 |
| Deferred income taxes | 21,640 | 23,699 |
| Other assets, net of accumulated amortization of \$1,508 and \$1,420, respectively | 2,656 | 2,528 |
| Goodwill | 4,433 | 4,433 |
| Total assets | \$465,167 | \$433,579 |
| LIABILITIES AND STOCKHOLDERS' EQUITY |  |  |
| Current liabilities: |  |  |
| Accounts payable | \$116,433 | \$ 109,314 |
| Accrued expenses | 61,847 | 76,887 |
| Current portion of capital lease obligations | 1,698 | 1,326 |
| Total current liabilities | 179,978 | 187,527 |
| Deferred rent, less current portion | 16,096 | 17,028 |
| Capital lease obligations, less current portion | 2,890 | 1,999 |
| Long-term debt | 47,920 | 10,000 |
| Other long-term liabilities | 11,501 | 11,988 |
| Total liabilities | 258,385 | 228,542 |
| Commitments and contingencies |  |  |
| Stockholders' equity: |  |  |
| Common stock, \$0.01 par value, authorized 50,000,000 shares; issued 24,921,672 and |  |  |
| 24,784,367 shares, respectively; outstanding 22,139,456 and 22,012,651 shares, respectively | 249 | 248 |
| Additional paid-in capital | 115,189 | 114,797 |
| Retained earnings | 125,851 | 124,363 |
| Less: Treasury stock, at cost; $2,782,216$ and $2,771,716$ shares, respectively | (34,507) | ( 34,371 ) |
| Total stockholders' equity | 206,782 | 205,037 |
| Total liabilities and stockholders' equity | \$465,167 | \$433,579 |

See accompanying notes to unaudited condensed consolidated financial statements.

- 3 -


## BIG 5 SPORTING GOODS CORPORATION

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

|  | 13 Weeks Ended |  | 26 Weeks Ended |  |
| :--- | :--- | :--- | :--- | :--- |
|  | July 2, | July 3, | July 2, | July 3, |
|  |  |  |  |  |
|  | 2017 | 2016 | 2017 | 2016 |
| Net sales | $\$ 243,671$ | $\$ 241,409$ | $\$ 496,275$ | $\$ 475,937$ |
| Cost of sales | 164,363 | 165,152 | 333,345 | 328,715 |
| Gross profit | 79,308 | 76,257 | 162,930 | 147,222 |
| Selling and administrative expense | 74,188 | 72,259 | 148,832 | 143,478 |
| Operating income | 5,120 | 3,998 | 14,098 | 3,744 |
| Interest expense | 380 | 429 | 648 | 881 |
| Income before income taxes | 4,740 | 3,569 | 13,450 | 2,863 |
| Income taxes | 1,962 | 1,445 | 5,346 | 1,858 |
| Net income | $\$ 2,778$ | $\$ 2,124$ | $\$ 8,104$ | $\$ 1,005$ |
| Earnings per share: | $\$ 0.13$ | $\$ 0.10$ | $\$ 0.37$ | $\$ 0.05$ |
| Basic | $\$ 0.13$ | $\$ 0.10$ | $\$ 0.37$ | $\$ 0.05$ |
| Diluted | $\$ 0.15$ | $\$ 0.125$ | $\$ 0.30$ | $\$ 0.25$ |
| Dividends per share |  |  |  |  |
| Weighted-average shares of common stock |  |  |  |  |
| outstanding: |  |  |  |  |
| Basic | 21,746 | 21,646 | 21,715 | 21,614 |
| Diluted | 21,871 | 21,740 | 21,923 | 21,784 |

See accompanying notes to unaudited condensed consolidated financial statements.
-4 -

## BIG 5 SPORTING GOODS CORPORATION

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands, except share amounts)

|  | Common Stock |  | Additional <br> Paid-In <br> Capital | Retained Earnings | Treasury Stock, At Cost | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Shares | Amount |  |  |  |  |
| Balance as of January 3, 2016 | 21,917,982 | \$ 246 | \$ 112,236 | \$118,998 | \$ $(32,649)$ | \$ 198,831 |
| Net income | - | - | - | 1,005 | - | 1,005 |
| Dividends on common stock ( $\$ 0.25$ per |  |  |  |  |  |  |
| share) | - | - | - | (5,490 ) | - | (5,490 |
| Issuance of nonvested share awards | 166,980 | 2 | (2 | ) - | - | - |
| Exercise of share option awards | 1,075 | - | 7 | - | - | 7 |
| Share-based compensation | - | - | 1,263 | - | - | 1,263 |
| Tax deficiency from share-based awards |  |  |  |  |  |  |


| activity | - | - | $(222$ | $)$ | - | - | $(222)$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Forfeiture of nonvested share awards | $(4,095$ | $)$ | - | - | - | - | - |

Retirement of common stock for payment

| of withholding tax | $(53,682$ | $)$ | $(1$ | $)$ | $(612$ | $)$ | - |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |


| share) | - | - | - | $(6,616$ | $)$ | - |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| $(6,616)$ |  |  |  |  |  |  |
| Issuance of nonvested share awards | 203,112 | 2 | $(2$ | $)$ | - | - |
| Exercise of share option awards | 4,150 | - | 28 | - | - | 28 |
| Share-based compensation | - | - | 1,170 | - | - | 1,170 |
| Forfeiture of nonvested share awards | $(15,945$ | $)$ | - | - | - | - |

Retirement of common stock for payment
$\left.\begin{array}{lllllllll}\text { of withholding tax } & (54,012 & ) & (1 & ) & (804 & ) & - & - \\ (1305 & ) & (136)\end{array}\right)$

See accompanying notes to unaudited condensed consolidated financial statements.

## BIG 5 SPORTING GOODS CORPORATION

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|  | 26 Weeks Ended |  |
| :---: | :---: | :---: |
|  | July 2, | July 3, |
|  | 2017 | 2016 |
| Cash flows from operating activities: |  |  |
| Net income | \$ 8,104 | \$ 1,005 |
| Adjustments to reconcile net income to net cash (used in) provided by operating activities: |  |  |
| Depreciation and amortization | 9,473 | 9,322 |
| Share-based compensation | 1,170 | 1,263 |
| Excess tax benefit related to share-based awards | - | (52 ) |
| Amortization of debt issuance costs | 88 | 88 |
| Deferred income taxes | 2,059 | 1,851 |
| Changes in operating assets and liabilities: |  |  |
| Accounts receivable, net | 75 | 866 |
| Merchandise inventories, net | (34,397) | (5,089 ) |
| Prepaid expenses and other assets | (1,662 ) | (2,050 ) |
| Accounts payable | 11,361 | 18,500 |
| Accrued expenses and other long-term liabilities | $(15,673)$ | (9,302 ) |
| Net cash (used in) provided by operating activities | (19,402) | 16,402 |
|  |  |  |
| Cash flows from investing activities: |  |  |
| Purchases of property and equipment | (7,153 ) | (6,813 ) |
| Net cash used in investing activities | (7,153 ) | (6,813 ) |
|  |  |  |
| Cash flows from financing activities: |  |  |
| Principal borrowings under revolving credit facility | 135,281 | 107,252 |
| Principal payments under revolving credit facility | $(97,361)$ | $(104,711)$ |
| Changes in book overdraft | (4,311) | (4,252 ) |
| Principal payments under capital lease obligations | (746 | (726 ) |
| Proceeds from exercise of share option awards | 28 | 7 |
| Excess tax benefit related to share-based awards | - | 52 |
| Purchases of treasury stock | (136 | (37 ) |
| Tax withholding payments for share-based compensation | (805 | (613 ) |
| Dividends paid | (6,662 | $(5,535)$ |
| Net cash provided by (used in) financing activities | 25,288 | (8,563 ) |
|  |  |  |
| Net (decrease) increase in cash | (1,267 ) | 1,026 |
|  |  |  |
| Cash at beginning of period | 7,895 | 7,119 |
|  |  |  |
| Cash at end of period | \$ 6,628 | \$ 8,145 |


| Supplemental disclosures of non-cash investing and financing activities: |  |  |
| :--- | :--- | :--- |
| Property and equipment acquired under capital leases | $\$ 2,009$ | $\$-$ |
| Property and equipment additions unpaid | $\$ 1,505$ | $\$ 1,438$ |
|  |  |  |
| Supplemental disclosures of cash flow information: | $\$ 469$ | $\$ 833$ |
| Interest paid | $\$ 8,309$ | $\$ 555$ |

See accompanying notes to unaudited condensed consolidated financial statements.

## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Description of Business

Big 5 Sporting Goods Corporation (the "Company") is a leading sporting goods retailer in the western United States, operating 433 stores and an e-commerce platform as of July 2, 2017. 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, winter and summer recreation and roller sports. The Company is a holding company that operates as one reportable segment through Big 5 Corp., its $100 \%$-owned subsidiary, and Big 5 Services Corp., which is a $100 \%$-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 $100 \%$-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, 2017 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 2017 is comprised of 52 weeks and ends on December 31, 2017. Fiscal year 2016 was comprised of 52 weeks and ended on January 1, 2017. The fiscal interim periods in fiscal 2017 and 2016 are each comprised of 13 weeks.

Recently Adopted Accounting Updates

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which includes multiple provisions intended to simplify various aspects of the accounting for share-based payments, including treatment of excess tax benefits and forfeitures, as well as consideration of minimum statutory tax withholding requirements. The ASU took effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016, with early application permitted as of the beginning of an interim or annual reporting period. The Company adopted this standard in the first quarter of fiscal 2017, coinciding with the standard's effective date, and has applied the effects of the adoption from the beginning of fiscal 2017, as follows:

Excess tax benefits or deficiencies are applied prospectively and recorded as a component of the income tax provision in the fiscal 2017 interim condensed consolidated statement of operations. Such amounts were previously recognized in additional paid-in capital, to the extent that there was a sufficient additional paid-in capital pool related to previously-recognized tax benefits, on the Company's consolidated balance sheets. No prior periods have been adjusted.
The Company had no unrecognized tax benefits related to its share-based payment awards at the adoption date. Therefore, no cumulative-effect adjustment to retained earnings was required as of the adoption date.

- 7 -

BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

Earnings per share amounts presented in the fiscal 2017 interim condensed consolidated statement of operations have been adjusted prospectively, and exclude the impact of assumed proceeds from tax benefits under the treasury stock method, since such amounts are now included as a component of the income tax provision and are no longer recognized in additional paid-in capital on the Company's consolidated balance sheet. No prior periods have been adjusted.
Excess tax benefits no longer represent financing activities since they are recognized in the fiscal 2017 interim condensed consolidated statement of operations; therefore, excess tax benefits have been classified as operating activities in the fiscal 2017 interim condensed consolidated statement of cash flows. The ASU eliminated the requirement to reclassify excess tax benefits from operating activities to financing activities. The Company elected to apply the change in presentation prospectively, and no prior periods have been adjusted.
The Company elected to continue to estimate the total number of awards for which the service period will not be rendered, which resulted in no change to the Company's Interim Financial Statements.
The Company currently presents cash payments to taxing authorities in connection with shares withheld to meet statutory tax withholding requirements as a financing activity, which resulted in no change to the Company's Interim Financial Statements.
The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

## Recently Issued Accounting Updates

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which was further clarified and amended in 2015 and 2016, and supersedes most preexisting revenue recognition guidance with a comprehensive new revenue recognition model. The core principle is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance also requires disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU No. 2014-09 will become effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017, with early application permitted. The Company plans to adopt this standard retrospectively with the cumulative effect of initially applying this ASU recognized in the first quarter of fiscal 2018, coinciding with the standard's effective date. While the Company is still evaluating this ASU, the Company has identified potential impacts to sales returns, gift cards, certain promotional programs and certain new required disclosures. The Company is in the process of analyzing its revenue streams for the areas discussed above, and currently does not expect that this standard will have a material impact on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires lessees to recognize on the balance sheet assets and liabilities for leases with lease terms of more than 12 months. Consistent with GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee will depend primarily on its classification as a finance or operating lease. However, unlike current GAAP-which requires only capital leases to be recognized on the balance sheet-the new ASU will require both types of leases to be recognized on the balance sheet. The ASU will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. This ASU shall be applied at the beginning of the earliest period presented using the modified retrospective approach, which includes a number of practical expedients that an entity may elect to apply. Early application of ASU No. 2016-02 is permitted. The Company plans to adopt this standard in
the first quarter of fiscal 2019, coinciding with the standard's effective date. While the Company is still evaluating this ASU, the Company has determined that the primary impact will be to recognize on the balance sheet all leases with remaining lease terms greater than 12 months. It is expected that this standard will have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which eliminates the second step of the goodwill impairment test. The new ASU requires application of a one-step quantitative test, and recognition of the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. The ASU will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, and shall be applied prospectively. Early application of ASU No. 2017-04 is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company plans to adopt this standard in the first quarter of fiscal 2020, coinciding with the standard's effective date. While the Company is still evaluating this ASU, it is not expected that this standard will have a material impact on the Company's consolidated financial statements.

- 8 -


## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

Other recently issued accounting updates are not expected to have a material impact on the Company's consolidated 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 as of 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 litigation, self-insurance liabilities and employee benefits. Actual results could differ significantly from these estimates under different assumptions and conditions.

## Revenue Recognition

The Company recognizes revenue from retail sales at the point of sale through its retail stores. For e-commerce sales, revenue is recognized when the merchandise is delivered to the customer. Shipping and handling fees, when billed to customers for e-commerce sales, are included in net sales and the related shipping and handling costs are included in cost of sales. An allowance for sales returns is estimated based upon historical experience and recorded as a reduction in sales in the relevant period.

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 does not sell gift cards that carry expiration dates. 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 second quarter of fiscal 2017). The Company recognized approximately $\$ 111,000$ and $\$ 223,000$ in gift card breakage revenue for the 13 and 26 weeks ended July 2, 2017, respectively, compared to approximately $\$ 112,000$ and $\$ 225,000$ in gift card breakage revenue for the 13 and 26 weeks ended July 3, 2016, respectively. The Company had outstanding gift card liabilities of $\$ 4.3$ million and $\$ 5.3$ million as of July 2, 2017 and January 1, 2017, respectively, which are included in accrued expenses.

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 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 10 to the Interim Financial Statements for a further discussion on share-based compensation.

Valuation of Merchandise Inventories, Net

The Company's merchandise inventories are made up of finished goods and are valued at the lower of cost or net realizable value 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, in-bound freight-related expense and allocated overhead expense associated with the Company's distribution center.

Management regularly reviews inventories and records valuation reserves for damaged and defective merchandise, merchandise items with slow-moving or obsolescence exposure and merchandise that has a carrying value that exceeds net realizable 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 primarily represents an estimate for inventory shrinkage for each store since the last physical inventory date through the reporting date.
-9 -

## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

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. Each store typically requires net investments of approximately $\$ 0.5$ million in long-lived assets to be held and used, subject to recoverability testing. 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.

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 evaluation 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 the 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.

The Company recognized no impairment charges in the first half of fiscal 2017 or 2016.
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, corporate office, IT systems hardware and distribution center delivery tractors. Capital lease obligations consist principally of leases for some of the Company's IT systems hardware.

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 "reasonably assured" lease term as a component of rent expense.

- 10 -


## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)
(3) Store Closing Costs

Store closing costs primarily include lease termination costs for leases that expire in January 2018. The following table summarizes the activity for the Company's store closing reserves:

Lease
Termination
Costs
(In thousands)
Balance at January 1, 2017 \$ 788
Store closing costs (165 )
Payments (428)

Balance at July 2, 2017 \$ 195
Store closing cost activity in the first half of fiscal 2017 reflects the early termination of two store leases that resulted in settlement of their lease obligations for less than the amounts originally recorded.

Accrued store closing costs is recorded in accrued expenses in the accompanying interim unaudited condensed consolidated balance sheet.
(4)Fair Value Measurements

The carrying values of cash, 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. When the Company recognizes impairment on certain of its underperforming stores, the carrying values of these stores' assets are reduced to their estimated fair values.

## (5) Accrued Expenses

The major components of accrued expenses are as follows:

January
July 2, 1,
20172017

|  | (In thousands) |  |
| :--- | :---: | ---: |
| Payroll and related expense | $\$ 22,441$ | $\$ 24,224$ |
| Occupancy expense | 10,020 | 10,981 |
| Sales tax | 7,042 | 11,376 |
| Other | 22,344 | 30,306 |
| Accrued expenses | $\$ 61,847$ | $\$ 76,887$ |

## (6)Long-Term Debt

On October 18, 2010, the Company entered into a credit agreement with Wells Fargo Bank, National Association ("Wells Fargo"), as administrative agent, and a syndicate of other lenders, which was amended on October 31, 2011 and December 19, 2013 (as so amended, the "Credit Agreement"). The maturity date of the Credit Agreement is December 19, 2018.

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.

- 11 -

BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

The Company 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 eligible credit card receivables; plus (b) the cost of eligible inventory (other than eligible in-transit 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); plus (c) the lesser of (i) the cost of eligible in-transit inventory, net of inventory reserves, multiplied by $90.00 \%$ of the appraised net orderly liquidation value of 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, the Company may designate specific borrowings under the Credit Facility as either base rate loans or LIBO rate loans. The applicable interest rate on the Company's borrowings is a function of the daily average, over the preceding fiscal quarter, of the excess of the Loan Cap over amounts borrowed (such amount being referred to as the "Average Daily Excess Availability"). Those loans designated as LIBO rate loans 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 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 is as set forth below as a function of Average Daily Excess Availability for the preceding fiscal quarter.

|  | LIBO <br> Rate | Base Rate |  |
| :--- | :--- | :---: | :---: |
|  |  |  |  |
|  | Applicable |  |  | Applicable

The commitment fee assessed on the unused portion of the Credit Facility is $0.25 \%$ per annum.
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 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

## Edgar Filing: BIG 5 SPORTING GOODS Corp - Form 10-Q

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. 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 the Company, 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.

As of July 2, 2017, the Company had long-term revolving credit borrowings of $\$ 47.9$ million and letter of credit commitments of $\$ 0.5$ million outstanding, compared with borrowings of $\$ 10.0$ million and letter of credit commitments of $\$ 0.5$ million as of January 1, 2017. Total remaining borrowing availability, after subtracting letters of credit, was $\$ 91.6$ million and $\$ 129.5$ million as of July 2, 2017 and January 1, 2017, respectively.

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)
(7) 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 July 2, 2017 and January 1, 2017, there was no valuation allowance for deferred income tax assets.

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 2013 and after, and state and local income tax returns are open for fiscal years 2012 and after.

The provision for income taxes for the 13 and 26 weeks ended July 3, 2016 reflects the write-off of deferred tax assets related to share-based compensation of $\$ 0.2$ million and $\$ 0.8$ million, respectively.

As of July 2, 2017 and January 1, 2017, the Company had no unrecognized tax benefits including those 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. As of July 2, 2017 and January 1, 2017, the Company had no accrued interest or penalties.

## (8) 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 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 |  |  | 26 Weeks Ended |  |
| :--- | :--- | :--- | :--- | :---: |
| July 2, | July 3, | July 2, | July 3, |  |
|  |  |  |  |  |
| 2017 | 2016 | 2017 | 2016 |  |
| (In thousands, except per share data) |  |  |  |  |


| Net income | \$2,778 | \$2,124 | \$8,104 | \$1,005 |
| :---: | :---: | :---: | :---: | :---: |
| Weighted-average shares of common stock outstanding: |  |  |  |  |
| Basic | 21,746 | 21,646 | 21,715 | 21,614 |
| Dilutive effect of common stock equivalents arising |  |  |  |  |
| from share option, nonvested share and nonvested |  |  |  |  |
| share unit awards | 125 | 94 | 208 | 170 |
| Diluted | 21,871 | 21,740 | 21,923 | 21,784 |
| Basic earnings per share | \$0.13 | \$0.10 | \$0.37 | \$0.05 |
| Diluted earnings per share | \$0.13 | \$0.10 | \$0.37 | \$0.05 |
| Antidilutive share option awards excluded |  |  |  |  |
| from diluted calculation | 71 | 182 | 84 | 282 |
| Antidilutive nonvested share and nonvested share unit |  |  |  |  |
| awards excluded from diluted calculation | 3 | 365 | - | - |

BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

The computation of diluted earnings per share for the 13 and 26 weeks ended July 2, 2017 and July 3, 2016 excludes share option awards 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 periods presented excludes nonvested share awards and nonvested share unit awards that were outstanding and antidilutive, since the grant date fair values of these nonvested share awards and nonvested share unit awards exceeded the average market price of the Company's common shares.

## (9) Commitments and Contingencies

In February 2008, the Company entered into a lease for a parcel of land with an existing building adjacent to its corporate headquarters location, including a parking lot currently used by the Company (the "premises"). The lease term commenced in 2009 and the primary term was originally scheduled to expire on February 28, 2019, subject to renewal for six successive periods of five years each. In accordance with terms of the lease agreement, the Company is committed to the construction of a new retail building on the premises before the primary term expires, regardless of whether or not any renewal options are exercised. In May 2017, the Company entered into an amendment to the lease to, among other things, extend the primary lease term, and consequently the construction deadline, to a date between February 29, 2020, and June 30, 2020, the exact date to be determined as described in more detail below. Such extension required a non-refundable payment of $\$ 40,000$, which the Company made concurrently with execution of the amendment. The amendment further sets forth the Company's intent to enter into a purchase and sale agreement, whereby the Company would have the right to purchase the premises for $\$ 4.5$ million, subject to a 120 -day due diligence period. If consummation of the sale fails to occur by June 30, 2018, then the Company's lease would remain in full force and effect, including the construction deadline, which would be the later of (a) February 29, 2020, or (b) the earlier of (i) two (2) years after the date that the purchase and sale agreement is terminated, or (ii) June 30, 2020. The Company is currently in the process of negotiating the purchase and sale agreement with the owner of the premises.

The Company is involved in various 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.
(10) 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 in April 2011 and April 2016 (the "Amended 2007 Plan"), and accounts for its share-based compensation in accordance with ASC 718. The Company recognized $\$ 0.6$ million and
$\$ 1.2$ million in share-based compensation expense for the 13 and 26 weeks ended July 2, 2017, respectively, compared to $\$ 0.6$ million and $\$ 1.3$ million in share-based compensation expense for the 13 and 26 weeks ended July 3 , 2016, 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 share option awards is equal to the quoted market price of the Company's common stock on the date of grant. No share option awards were granted in the first half of fiscal 2017 and 2016.

As of July 2, 2017, there was $\$ 0.1$ million of total unrecognized compensation expense related to nonvested share option awards granted. That expense is expected to be recognized over a weighted-average period of 1.8 years.

## Nonvested Share Awards and Nonvested Share Unit Awards

Nonvested share awards and nonvested share unit awards granted by the Company have historically vested from the date of grant in four equal annual installments of $25 \%$ per year. In accordance with the Company's Director Compensation Program, nonvested share awards and nonvested share unit awards granted by the Company to non-employee directors vest $100 \%$ on the first anniversary of the grant date.

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 first half of fiscal 2017 and 2016 was

- 14 -


## BIG 5 SPORTING GOODS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)
$\$ 2.0$ million and $\$ 1.6$ million, respectively. The total fair value of nonvested share unit awards which vested during the first half of fiscal 2017 and 2016 was $\$ 0.3$ million and $\$ 0.5$ million, respectively.

The Company granted 191,000 and 166,980 nonvested share awards in the first half of fiscal 2017 and 2016, respectively. The weighted-average grant-date fair value per share of the Company's nonvested share awards granted in the first half of fiscal 2017 and 2016 was $\$ 14.88$ and $\$ 11.35$, respectively.

The Company granted 21,000 and 25,200 nonvested share unit awards in the first half of fiscal 2017 and 2016, respectively. The weighted-average grant-date fair value per share of the Company's nonvested share unit awards granted in the first half of fiscal 2017 and 2016 was $\$ 13.90$ and $\$ 8.87$, respectively.

The following table details the Company's nonvested share awards activity for the 26 weeks ended July 2, 2017:

Weighted-
Average
Grant-

Date Fair
Shares Value
Balance at January 1, 2017 355,130 \$ 12.86
Granted $\quad 191,000 \quad 14.88$
Vested $\quad(137,135) \quad 13.46$
Forfeited (15,945) 13.43
Balance at July 2, $2017 \quad 393,050 \quad \$ 13.61$

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 first half of fiscal 2017, the Company withheld 54,012 common shares with a total value of $\$ 0.8$ million. This amount is presented as a cash outflow from financing activities in the accompanying interim unaudited condensed consolidated statement of cash flows.

As of July 2, 2017, there was $\$ 4.6$ million and $\$ 0.3$ million of total unrecognized compensation expense related to nonvested share awards and nonvested share unit awards, respectively. That expense is expected to be recognized over a weighted-average period of 2.8 years and 0.9 years for nonvested share awards and nonvested share unit awards, respectively.
(11) Subsequent Event

In the third quarter of fiscal 2017, the Company's Board of Directors declared a quarterly cash dividend of $\$ 0.15$ per share of outstanding common stock, which will be paid on September 15, 2017 to stockholders of record as of September 1, 2017.

- 15 -


## 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 "Company") as of July 2, 2017, and the related condensed consolidated statements of operations for the 13 and 26 weeks ended July 2, 2017 and July 3, 2016, and of stockholders' equity and cash flows for the 26 weeks ended July 2, 2017 and July 3, 2016. These interim financial statements are the responsibility of the Company'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, 2017, 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 March 1, 2017, 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, 2017 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
August 2, 2017

## Edgar Filing: BIG 5 SPORTING GOODS Corp - Form 10-Q

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, related notes, Risk Factors 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, 2017.

Our fiscal year ends on the Sunday nearest December 31. Fiscal 2017 includes 52 weeks and ends on December 31, 2017. Fiscal 2016 included 52 weeks and ended on January 1, 2017. The fiscal interim periods in fiscal 2017 and 2016 are each comprised of 13 weeks.

## Overview

We are a leading sporting goods retailer in the western United States, operating 433 stores and an e-commerce platform under the name "Big 5 Sporting Goods" as of July 2, 2017. 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, winter and summer recreation and roller sports.

## Executive Summary

Our earnings for the second quarter of fiscal 2017 increased compared to the second quarter of fiscal 2016 primarily due to the favorable impact of higher net sales, improved merchandise margins and lower distribution expense, partially offset by higher selling and administrative expense. Same store sales increased $0.8 \%$ for the 13 weeks ended July 2, 2017, versus the comparable 13-week period in the prior year.

Net sales for the second quarter of fiscal 2017 increased $0.9 \%$ to $\$ 243.7$ million compared to $\$ 241.4$ million for the second quarter of fiscal 2016. The increase in net sales was primarily attributable to added sales from new stores opened since April 3, 2016 and an increase in same store sales, partially offset by a reduction in sales from closed stores. Net and same store sales benefited from the liquidation and closure of certain major competitors that concluded in the third quarter of fiscal 2016, but also reflected lower demand for certain hardgoods categories, primarily products related to firearms, camping and water sports. Net and same store sales comparisons to the prior year were unfavorably impacted by calendar shifts related to the Easter and July $4^{\text {th }}$ holidays. For the second quarter of fiscal 2017, same store sales for our apparel and footwear categories increased, partially offset by a decrease in same store sales for our hardgoods category.
Net income for the second quarter of fiscal 2017 was $\$ 2.8$ million, or $\$ 0.13$ per diluted share, compared to net income of $\$ 2.1$ million, or $\$ 0.10$ per diluted share, for the second quarter of fiscal 2016. The higher net income was driven primarily by higher net sales, improved merchandise margins and lower distribution expense, partially offset by higher selling and administrative expense.
Gross profit for the second quarter of fiscal 2017 represented $32.5 \%$ of net sales, compared with $31.6 \%$ in the second quarter of the prior year. The increase in gross profit margin resulted mainly from higher merchandise margins as well as lower distribution expense as a percentage of net sales.
Selling and administrative expense for the second quarter of fiscal 2017 increased $2.6 \%$ to $\$ 74.2$ million, or $30.4 \%$ of net sales, compared to $\$ 72.3$ million, or $29.9 \%$ of net sales, for the second quarter of fiscal 2016. The increase in selling and administrative expense was primarily attributable to higher labor and expense associated with various IT-related systems and services.

Operating cash flow in the first half of fiscal 2017 was a negative $\$ 19.4$ million compared to operating cash flow in the first half of fiscal 2016 of a positive $\$ 16.4$ million, due primarily to increased funding of merchandise inventory. Capital expenditures for the first half of fiscal 2017 increased to $\$ 7.2$ million from $\$ 6.8$ million for the first half of fiscal 2016.
The balance under our revolving credit facility was $\$ 47.9$ million as of July 2,2017 , compared with $\$ 57.4$ million as of July 3, 2016 and $\$ 10.0$ million as of January 1, 2017.
We paid cash dividends in the first half of fiscal 2017 of $\$ 6.7$ million, or $\$ 0.30$ per share, compared with $\$ 5.5$ million, or $\$ 0.25$ per share, in the first half of fiscal 2016.

- 17 -


## Results of Operations

The results of the interim periods are not necessarily indicative of results for the entire fiscal year.
13 Weeks Ended July 2, 2017 Compared to 13 Weeks Ended July 3, 2016
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 <br> July 2, 2017 <br> (Dollars in thousands) | July 3, 2016 |
| :--- | :--- | :--- | :--- | :--- |

${ }^{(1)}$ Cost of sales includes the cost of merchandise, net of discounts or allowances earned, freight, inventory reserves, buying, distribution center expense, including depreciation and amortization, and store occupancy expense. Store occupancy expense includes rent, amortization of leasehold improvements, common area maintenance, property taxes and insurance.
${ }^{(2)}$ Selling and administrative expense includes store-related expense, other than store occupancy expense, as well as advertising, depreciation and amortization, expense associated with operating our corporate headquarters and impairment charges, if any.
Net Sales. Net sales increased by $\$ 2.3$ million, or $0.9 \%$, to $\$ 243.7$ million in the second quarter ended July 2, 2017 from $\$ 241.4$ million in the second quarter last year. The change in net sales reflected the following:

Same store sales increased by $\$ 2.0$ million, or $0.8 \%$, for the 13 weeks ended July 2, 2017, versus the comparable 13 -week period in the prior year. Our same store sales benefited from the liquidation and closure of certain major competitors that concluded in the third quarter of fiscal 2016, but also reflected lower demand for certain hardgoods categories, primarily products related to firearms, camping and water sports. Our higher same store sales reflected increases in our major merchandise categories of apparel and footwear, partially offset by a decrease in sales for hardgoods. We expect to cycle the benefit of the competitive rationalization in the third quarter of fiscal 2017, which could impact year-over-year sales comparisons for the second half of fiscal 2017. 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, and same store sales comparisons exclude sales from stores closed during the comparable periods.
Net and same store sales comparisons year over year reflected the unfavorable impact of calendar shifts related to the Easter and July $4^{\text {th }}$ holidays.
A reduction in sales from closed stores was largely offset by added sales from new stores opened since April 3, 2016.
We experienced increased customer transactions that reflected the liquidation and closure of certain major competitors that concluded in the third quarter of fiscal 2016. We also achieved a higher average sale per transaction in the second quarter of fiscal 2017 compared to the same period last year.

## Edgar Filing: BIG 5 SPORTING GOODS Corp - Form 10-Q

Store count as of July 2, 2017 was 433 versus 435 as of July 3, 2016. We opened two new stores in the 13 weeks ended July 2, 2017. We opened two new stores and closed one store in the 13 weeks ended July 3, 2016. For fiscal 2017, we anticipate opening approximately six new stores and closing approximately three stores.

Gross Profit. Gross profit increased by $\$ 3.0$ million, or $3.9 \%$, to $\$ 79.3$ million, or $32.5 \%$ of net sales, in the 13 weeks ended July 2, 2017, from $\$ 76.3$ million, or $31.6 \%$ of net sales, in the 13 weeks ended July 3, 2016. The change in gross profit was primarily attributable to the following:

Net sales increased by $\$ 2.3$ million, or $0.9 \%$, compared with the second quarter of last year.

- Merchandise margins, which exclude buying, occupancy and distribution expense, increased by a favorable 37 basis points compared with the second quarter of last year. This increase primarily reflected a shift in sales mix towards higher-margin products such as apparel and away from lower-margin products such as firearms.
Distribution expense, including costs capitalized into inventory, decreased by $\$ 1.5$ million, or a favorable 66 basis points, in the second quarter of fiscal 2017 compared to the prior year. Increased costs capitalized into inventory were partially offset by higher warehouse expense primarily related to employee labor and benefit-related expense. Selling and Administrative Expense. Selling and administrative expense increased by $\$ 1.9$ million to $\$ 74.2$ million, or $30.4 \%$ of net sales, in the 13 weeks ended July 2, 2017 from $\$ 72.3$ million, or $29.9 \%$ of net sales, in the second quarter last year. The change in selling and administrative expense was primarily attributable to the following:

Administrative expense increased by $\$ 0.9$ million, primarily attributable to higher expense associated with various IT-related systems and services of $\$ 0.7$ million.
Store-related expense, excluding occupancy, increased by $\$ 0.9$ million due primarily to higher employee labor expense. Our labor expense continues to reflect the incremental impact of legislated minimum wage rate increases primarily in California, where over fifty percent of our store operations are located. In April 2016, California passed legislation to enact minimum wage rate increases from $\$ 10.00$ to $\$ 15.00$ per hour to be implemented in annual increments through fiscal 2022, with annual increases of $\$ 0.50$ per hour effective in fiscal 2017 and fiscal 2018, and annual increases of $\$ 1.00$ per hour effective in fiscal 2019 through fiscal 2022. We estimate that the impact of the California minimum wage rate increase of $\$ 0.50$ per hour effective in January 2017 caused our labor expense to increase by approximately $\$ 0.3$ million for the second quarter of fiscal 2017.
Interest Expense. Interest expense remained unchanged in the second quarter of fiscal 2017 compared to the second quarter of fiscal 2016.

Income Taxes. The provision for income taxes was $\$ 2.0$ million for the 13 weeks ended July 2, 2017 and $\$ 1.4$ million for the 13 weeks ended July 3, 2016, primarily due to higher pre-tax income in the second quarter of fiscal 2017. Our effective tax rate was $41.4 \%$ for the second quarter of fiscal 2017 and $40.5 \%$ for the second quarter of fiscal 2016.

26 Weeks Ended July 2, 2017 Compared to 26 Weeks Ended July 3, 2016
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:

|  | 26 Weeks Ended <br> July 2, 2017 <br> (Dollars in thousands) | July 3, 2016 |
| :--- | :--- | :--- | :--- | :--- |

${ }^{(1)}$ Cost of sales includes the cost of merchandise, net of discounts or allowances earned, freight, inventory reserves, buying, distribution center expense, including depreciation and amortization, and store occupancy expense. Store occupancy expense includes rent, amortization of leasehold improvements, common area maintenance, property taxes and insurance.
${ }^{(2)}$ Selling and administrative expense includes store-related expense, other than store occupancy expense, as well as advertising, depreciation and amortization, expense associated with operating our corporate headquarters and impairment charges, if any.
Net Sales. Net sales increased by $\$ 20.4$ million, or $4.3 \%$, to $\$ 496.3$ million in the 26 weeks ended July 2, 2017 from $\$ 475.9$ million in the first 26 weeks last year. The change in net sales reflected the following:

Same store sales increased by $\$ 20.0$ million, or $4.3 \%$, for the 26 weeks ended July 2, 2017, versus the comparable 26 -week period in the prior year. Our higher same store sales reflected the benefit from the liquidation and closure of certain major competitors that concluded in the third quarter of fiscal 2016, along with more favorable weather conditions in the first quarter of this year. Our higher same store sales for the 26 weeks ended July 2, 2017 reflected increases in our major merchandise categories of apparel and footwear and a slight decrease in sales for hardgoods. We expect to cycle the benefit of the competitive rationalization in the third quarter of fiscal 2017, which could impact year-over-year sales comparisons for the second half of fiscal 2017. 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, and same store sales comparisons exclude sales from stores closed during the comparable periods.
A reduction in sales from closed stores was largely offset by added sales from new stores opened since January 3, 2016.

We experienced increased customer transactions that reflected the liquidation and closure of certain major competitors that concluded in the third quarter of fiscal 2016. We also achieved a higher average sale per transaction in the first half of fiscal 2017 compared to the same period last year.
Store count as of July 2, 2017 was 433 versus 435 as of July 3, 2016. We opened three stores, one of which was a relocation, and closed two stores, one of which was a relocation, in the 26 weeks ended July 2, 2017. We opened two new stores and closed five stores, one of which was a relocation, in the 26 weeks ended July 3, 2016. For fiscal 2017, we anticipate opening approximately six new stores and closing approximately three stores.

Gross Profit. Gross profit increased by $\$ 15.7$ million, or $10.7 \%$, to $\$ 162.9$ million, or $32.8 \%$ of net sales, in the 26 weeks ended July 2, 2017, from $\$ 147.2$ million, or $30.9 \%$ of net sales, in the 26 weeks ended July 3, 2016. The change in gross profit was primarily attributable to the following:

Net sales increased by $\$ 20.4$ million, or $4.3 \%$, compared with the first half of last year.

- 20 -

Merchandise margins, which exclude buying, occupancy and distribution expense, increased by a favorable 132 basis points compared with the first half of last year. This increase reflected a shift in sales mix driven primarily by strong demand for winter products as a result of favorable weather conditions and reduced demand for lower-margin products such as firearms, combined with the positive impact of lower clearance activity and reduced promotional activities that resulted from competitive store closures in our markets in fiscal 2016.
Distribution expense, including costs capitalized into inventory, decreased by $\$ 1.7$ million, or a favorable 51 basis points, in the first half of fiscal 2017 compared to the prior year. Increased costs capitalized into inventory and lower trucking expense were partially offset by higher employee labor and benefit-related expense.
Store occupancy expense increased by $\$ 0.9$ million year over year in the first half of fiscal 2017. Store occupancy expense as a percentage of sales decreased by a favorable 21 basis points.
Selling and Administrative Expense. Selling and administrative expense increased by $\$ 5.3$ million to $\$ 148.8$ million, or $30.0 \%$ of net sales, in the 26 weeks ended July 2,2017 , from $\$ 143.5$ million, or $30.1 \%$ of net sales, in the first half of last year. The change in selling and administrative expense was primarily attributable to the following:

Administrative expense increased by $\$ 3.1$ million, primarily attributable to higher expense associated with various IT-related systems and services of $\$ 1.3$ million and higher employee labor and benefit-related expense of $\$ 1.3$ million.
Store-related expense, excluding occupancy, increased by $\$ 2.8$ million due primarily to higher employee labor expense, as well as expense for IT-related systems and services and credit card fees. Our labor expense continues to reflect the incremental impact of legislated minimum wage rate increases primarily in California, where over fifty percent of our store operations are located. In April 2016, California passed legislation to enact minimum wage rate increases from $\$ 10.00$ to $\$ 15.00$ per hour to be implemented in annual increments through fiscal 2022, with annual increases of $\$ 0.50$ per hour effective in fiscal 2017 and fiscal 2018, and annual increases of $\$ 1.00$ per hour effective in fiscal 2019 through fiscal 2022. We estimate that the impact of the California minimum wage rate increase of $\$ 0.50$ per hour effective in January 2017 caused our labor expense to increase by approximately $\$ 0.6$ million for the first half of fiscal 2017.

- Advertising expense for the first half of fiscal 2017 decreased by $\$ 0.6$ million.
Interest Expense. Interest expense decreased by $\$ 0.2$ million in the 26 weeks ended July 2, 2017 compared to the 26 weeks ended July 3, 2016.

Income Taxes. The provision for income taxes was $\$ 5.3$ million for the 26 weeks ended July 2, 2017 and $\$ 1.9$ million for the 26 weeks ended July 3, 2016. The increase was primarily due to higher pre-tax income in the first half of fiscal 2017. Our effective tax rate was $39.7 \%$ for the 26 weeks ended July 2, 2017 and $64.9 \%$ for the 26 weeks ended July 3, 2016. The provision for income taxes for the 26 weeks ended July 3, 2016 reflected the write-off of deferred tax assets related to share-based compensation of $\$ 0.8$ million.

## 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 on hand, cash flows from operations and borrowings from our revolving credit facility. We believe our cash 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.

As of July 2, 2017, we had $\$ 6.6$ million of cash compared with $\$ 8.1$ million as of July 3, 2016. Our cash flows from operating, investing and financing activities are summarized as follows:

| 26 Weeks Ended |  |
| :---: | :---: |
| July 2, | July 3, |
| 2017 | 2016 |
| (In thousands) |  |
| \$ $(19,402)$ | ) $\$ 16,402$ |
| (7,153 ) | ) $(6,813)$ |
| 25,288 | $(8,563)$ |
| \$(1,267 ) | ) $\$ 1,026$ |

Operating Activities. Net cash used in operating activities for the 26 weeks ended July 2, 2017 was $\$ 19.4$ million, and net cash provided by operating activities for the 26 weeks ended July 3, 2016 was $\$ 16.4$ million. The decrease in cash flow from operating activities for the first half of fiscal 2017 compared to the same period last year primarily reflects a larger increase in merchandise inventory for the current year compared with the prior year, combined with the timing of payments for purchases of merchandise inventory resulting in a smaller increase in accounts payable balances during the first half of fiscal 2017 compared with the prior year, as well as reductions in accrued expense primarily related to income taxes. This increased funding was partially offset by higher net income in the first half of fiscal 2017.

Investing Activities. Net cash used in investing activities for the 26 weeks ended July 2, 2017 and July 3, 2016 was $\$ 7.2$ million and $\$ 6.8$ million, respectively. Capital expenditures, excluding non-cash acquisitions, represented all of the cash used in investing activities for each period. Capital expenditures for both periods reflect new store investments, store-related remodeling, distribution center investments and computer hardware and software purchases.

Financing Activities. Net cash provided by financing activities for the 26 weeks ended July 2, 2017 was $\$ 25.3$ million, and net cash used in financing activities for the 26 weeks ended July 3, 2016 was $\$ 8.6$ million. For the first half of fiscal 2017, net cash was provided primarily from increased borrowings under our revolving credit facility, partially offset by dividend payments. For the first half of fiscal 2016, net cash was used primarily to fund dividend and debt payments.

As of July 2, 2017, we had revolving credit borrowings of $\$ 47.9$ million and letter of credit commitments of $\$ 0.5$ million outstanding. These balances compare to revolving credit borrowings of $\$ 10.0$ million and letter of credit commitments of $\$ 0.5$ million outstanding as of January 1,2017 and revolving credit borrowings of $\$ 57.4$ million and letter of credit commitments of $\$ 0.5$ million outstanding as of July 3, 2016. We have increased our purchases of merchandise inventory in fiscal 2017 compared with the prior year to support anticipated customer demand resulting from competitive closures in our markets. Such increased purchases resulted in increased borrowings under our revolving credit facility in the first half of fiscal 2017.

In the first nine months of fiscal 2016 we paid quarterly cash dividends of $\$ 0.125$ per share of outstanding common stock, and in the fourth quarter of fiscal 2016 we paid a quarterly cash dividend of $\$ 0.15$ per share of outstanding common stock, for an annual rate of $\$ 0.525$ per share. In the first half of fiscal 2017 we paid quarterly cash dividends of $\$ 0.15$ per share of outstanding common stock, for an annual rate of $\$ 0.60$ per share. In the third quarter of fiscal 2017, our Board of Directors declared a quarterly cash dividend of $\$ 0.15$ per share of outstanding common stock, which will be paid on September 15, 2017 to stockholders of record as of September 1, 2017.

Periodically, we repurchase our common stock in the open market pursuant to programs approved by our Board of Directors. We may repurchase our common stock for a variety of reasons, including, among other things, our alternative cash requirements, existing business conditions and the current market price of our stock. In the third quarter of fiscal 2016, our Board of Directors authorized a new share repurchase program for the purchase of up to $\$ 25.0$ million of our common stock. This program replaced the previous share repurchase program, under which $\$ 2.9$ million remained available for repurchases. Under the current authorization, we 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 Securities and Exchange Commission ("SEC"). However, the timing and amount of such purchases, if any, would be at the discretion of our management and Board of Directors, and would depend on market conditions and other considerations. In the first half of fiscal 2017 , we repurchased 10,500 shares of common stock for $\$ 136,000$. In the first half of fiscal 2016, we repurchased 3,900 shares of common stock for $\$ 37,000$. Since the inception of our initial share repurchase program in May 2006 through July 2, 2017, we have repurchased a total of 2,668,006 shares for $\$ 33.8$ million. As of July 2, 2017, a total of $\$ 23.3$ million remained available for share repurchases under our current share repurchase program.

- 22 -

Credit Agreement. On October 18, 2010, we entered into a credit agreement with Wells Fargo Bank, National Association ("Wells Fargo"), as administrative agent, and a syndicate of other lenders, which was amended on October 31, 2011 and December 19, 2013 (as so amended, the "Credit Agreement"). The maturity date of the Credit Agreement is December 19, 2018.

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. Total remaining borrowing availability under the Credit Agreement, after subtracting letters of credit, was $\$ 91.6$ million and $\$ 129.5$ million as of July 2, 2017 and January 1, 2017, 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"). After giving effect to the amendments, the "Borrowing Base" generally is comprised of the sum, at the time of calculation, of (a) $90.00 \%$ of our eligible credit card receivables; plus (b) the cost of our eligible inventory (other than our eligible in-transit 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); plus (c) the lesser of (i) the cost of our eligible in-transit inventory, net of inventory reserves, multiplied by $90.00 \%$ 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. The applicable interest rate on our borrowings will be a function of the daily average, over the preceding fiscal quarter, of the excess of the Loan Cap 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.

|  |  | LIBO Rate | Base Rate |
| :--- | :--- | :---: | :---: |
| Level | Average Daily Excess Availability |  | Applicable Margin | Applicable Margin |  |  |
| :--- | :--- |
| I | Greater than or equal to $\$ 100,000,000$ |

The commitment fee assessed on the unused portion of the Credit Facility is $0.25 \%$ 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.

Future Capital Requirements. We had cash on hand of $\$ 6.6$ million as of July 2, 2017. We expect capital expenditures for fiscal 2017, excluding non-cash acquisitions, to range from approximately $\$ 18.0$ million to $\$ 22.0$ million primarily to fund the opening of new stores, store-related remodeling, distribution center investments and computer hardware and software purchases, including amounts related to the development of a new point-of-sale system. As more fully described in Note 9 to the Interim Financial Statements included in Part 1, Item 1, Financial Statements, of this Quarterly Report on Form 10-Q, we may also acquire for $\$ 4.5$ million a parcel of land that we currently lease. This parcel of land with an existing building is adjacent to our corporate
headquarters location and includes a parking lot currently used by us. For fiscal 2017, we anticipate opening approximately six new stores and closing approximately three stores.

We currently pay quarterly dividends, subject to declaration by our Board of Directors. In the third quarter of fiscal 2017, our Board of Directors declared a quarterly cash dividend of $\$ 0.15$ per share of outstanding common stock, which will be paid on September 15, 2017 to stockholders of record as of September 1, 2017.

In the third quarter of fiscal 2016, our Board of Directors authorized a new share repurchase program of up to $\$ 25.0$ million of our common stock, which replaced the previous share repurchase program. We consider several factors in determining when and if we make share repurchases including, among other things, our alternative cash requirements, existing business conditions and the market price of our stock. As of July 2, 2017, a total of $\$ 23.3$ million remained available under the current share repurchase program.

We believe we will be able to fund our cash requirements from cash on hand, operating cash flows and borrowings from our revolving credit facility, for at least the next 12 months. 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, as well as financial, competitive, business and other factors affecting our operations, including factors beyond our control.

Off-Balance Sheet Arrangements and Contractual Obligations. Our material off-balance sheet arrangements are operating lease obligations. 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. Operating lease commitments also consist of IT systems hardware and distribution center delivery tractors.

Our material contractual obligations include operating lease commitments associated with our leased properties and other occupancy expense, capital lease obligations, borrowings under our Credit Facility and other liabilities.

Issued and outstanding letters of credit were $\$ 0.5$ million as of July 2, 2017, and were related 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, 2017, is a discussion of our future obligations and commitments as of January 1, 2017. In the first half of fiscal 2017, our revolving credit borrowings increased by $\$ 37.9$ million from the end of fiscal 2016. We entered into new operating lease agreements in relation to our business operations during the first half of fiscal 2017. We do not believe that these operating leases or the changes to our revolving credit borrowings materially impact our contractual obligations or commitments presented as of January 1, 2017.

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, 2017, we consider our estimates on inventory valuation, long-lived assets and self-insurance liabilities 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 26 weeks ended July 2, 2017.

## Seasonality and Impact of Inflation

We experience seasonal fluctuations in our net sales and operating results. 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 and supplement our merchandise assortment as necessary and when possible during the season. Our efforts to replenish products during a season are not always successful. In the fourth fiscal quarter, which includes the holiday selling season and the start of the winter selling season, we normally experience higher inventory purchase volumes and increased expense for staffing and advertising. If we miscalculate the demand for our products generally or for our product mix in advance of a season, particularly the fourth quarter, our net sales can decline, which can harm our financial performance. A significant shortfall from expected net sales, particularly during the fourth quarter, can negatively impact our annual operating results.

In fiscal 2016, and during the first half of fiscal 2017, the impact of inflation was minimal. We have evolved our product mix to include more branded merchandise that we believe gives us added flexibility to adjust selling prices for purchase cost increases. If we are unable to adjust our selling prices for purchase cost increases that might occur, then our merchandise margins will decline,
which will adversely impact our operating results. We do not believe that inflation had a material impact on our operating results for the reporting periods.

## 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," "p "anticipates," "believes," "intends" or other such terminology. These forward-looking statements involve known and 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, breach of data security or other unauthorized disclosure of sensitive personal or confidential information, the competitive environment in the sporting goods industry in general and in our specific market areas, inflation, product availability and growth opportunities, changes in the current market for (or regulation of) firearm-related products, seasonal fluctuations, weather conditions, changes in cost of goods, operating expense fluctuations, changes in laws or regulations, including those related to tariffs and duties, lower-than-expected profitability of our e-commerce platform or cannibalization of sales from our existing store base which could occur as a result of operating our e-commerce platform, litigation risks, stockholder campaigns and proxy contests, disruption in product flow, changes in interest rates, credit availability, higher expense 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 SEC. 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 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 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 as of July 2, 2017, our interest expense would change approximately $\$ 0.5$ million on an annual basis based on the outstanding balance of borrowings under our Credit Facility as of July 2, 2017.

Inflationary factors and changes in foreign currency rates can increase the purchase cost of our products. We have evolved our product mix to include more branded merchandise, which we believe gives us added flexibility to adjust selling prices for purchase cost increases. If we are unable to adjust our selling prices for purchase cost increases that might occur then our merchandise margins will decline, which will adversely impact our operating results. All of our stores are located in the United States, and all imported merchandise is purchased in U.S. dollars. We do not believe that inflation had a material impact on our operating results for the reporting periods.

## 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 July 2, 2017, 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.

- 26 -


## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

The Company is involved in various 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, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
The following tabular summary reflects the Company's share repurchase activity during the quarter ended July 2 , 2017:

## ISSUER PURCHASES OF EQUITY SECURITIES

|  |  |  | Maximum Number (or |  |
| :--- | :--- | :--- | :--- | :--- |
|  |  |  | Total Number of | Approximate Dollar |

${ }^{(1)}$ In the third quarter of fiscal 2016, the Company's Board of Directors authorized the current share repurchase program for the purchase of up to $\$ 25.0$ million of the Company's common stock. This program replaced the Company's previous share repurchase program, under which $\$ 2.9$ million remained available for repurchase. All share repurchases shown in this table were made under the Company's current share repurchase program. Under the
current 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 Securities and Exchange Commission. However, the timing and amount of such purchases, if any, would be at the discretion of the Company's management and Board of Directors and would depend upon market conditions and other considerations. Since the inception of its initial share repurchase program in May 2006 through July 2, 2017, the Company has repurchased a total of $2,668,006$ shares for $\$ 33.8$ million. As of July 2, 2017, a total of $\$ 23.3$ million remained available for share repurchases under the current share repurchase program.
${ }^{(2)}$ 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.
${ }^{(3)}$ This amount reflects the dollar value of shares remaining available to repurchase under the Company's current share repurchase program.
Item 3. Defaults Upon Senior Securities
Not applicable.
Item 4. Mine Safety Disclosures
Not applicable.

- 27 -

Item 5. Other Information
Not applicable.
Item 6. Exhibits
(a)Exhibits

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

## 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,<br>a Delaware corporation

Date: August 2, 2017 By:/s/ Steven G. Miller
Steven G. Miller
Chairman of the Board of Directors,
President and Chief Executive Officer
Date: August 2, 2017 By:/s/ Barry D. Emerson
Barry D. Emerson
Senior Vice President,

Chief Financial Officer and Treasurer
(Principal Financial and
Accounting Officer)

