AMERICAN EAGLE OUTFITTERS INC
Form 10-Q
May 24, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended April 28, 2012

OR

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

Commission File Number: 1-33338

American Eagle Outfitters, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

N/A

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 195,969,496 Common Shares were outstanding at May 21, 2012.

Table of Contents

AMERICAN EAGLE OUTFITTERS, INC.

TABLE OF CONTENTS

Table of Contents

PART I- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)	April 28, 2012 (Unaudited)	January 28, 2012	April 30, 2011 (Unaudited)
Assets			
Current assets:			
Cash and cash equivalents	$ 713,443	$ 719,545	$ 474,668
Short-term investments	8,587	25,499	130,513
Merchandise inventory	376,688	378,426	331,588
Accounts receivable	37,472	40,310	31,464
Prepaid expenses and other	75,433	74,947	84,687
Deferred income taxes	48,358	48,761	49,023
Total current assets	1,259,981	1,287,488	1,101,943
Property and equipment, at cost, net of accumulated depreciation	572,104	582,162	641,907
Intangible assets, at cost, net of accumulated amortization	39,556	39,832	40,454
Goodwill	11,544	11,469	11,710
Non-current deferred income taxes	16,579	13,467	10,030
Other assets	16,688	16,384	26,294
Total assets	$ 1,916,452	$ 1,950,802	$ 1,832,338
Liabilities and Stockholders Equity			
Current liabilities:			
Accounts payable	$ 133,861	$ 183,783	$ 155,183
Accrued compensation and payroll taxes	21,970	42,625	14,915
Accrued rent	76,550	76,921	70,873
Accrued income and other taxes	14,333	20,135	12,242
Unredeemed gift cards and gift certificates	30,783	44,970	29,187
Current portion of deferred lease credits	14,945	15,066	15,981
Other liabilities and accrued expenses	25,779	21,901	24,566
Total current liabilities	318,221	405,401	322,947
Non-current liabilities:			
Deferred lease credits	73,350	71,880	79,131
Non-current accrued income taxes	31,806	35,471	40,310
Other non-current liabilities	22,544	21,199	23,486
Total non-current liabilities	127,700	128,550	142,927
Commitments and contingencies			
Stockholders equity:			
Preferred stock, $0.01 par value; 5,000 shares authorized; none issued and outstanding			
Common stock, $0.01 par value; 600,000 shares authorized; 249,566, 249,566 and 249,566 shares issued; 195,841, 193,848 and 194,871 shares outstanding, respectively	2,496	2,496	2,496
Contributed capital	567,700	552,797	543,393
Accumulated other comprehensive income	30,532	28,659	33,573
Retained earnings	1,774,205	1,771,464	1,716,173
Treasury stock, 53,725, 55,718 and 54,695 shares, respectively	(904,402)	(938,565)	(929,171)

Total stockholders equity	1,470,531	1,416,851	1,366,464
Total liabilities and stockholders equity	$ 1,916,452	$ 1,950,802	$ 1,832,338

Refer to Notes to Consolidated Financial Statements

3

Table of Contents

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

(Unaudited)

	13 Weeks Ended	
(In thousands, except per share amounts)	April 28, 2012	April 30, 2011
Net sales	$ 719,093	$ 609,562
Cost of sales, including certain buying, occupancy and warehousing expenses	446,430	377,801
Gross profit	272,663	231,761
Selling, general and administrative expenses	182,605	158,491
Depreciation and amortization expense	32,798	34,880
Operating income	57,260	38,390
Other income, net	3,507	4,512
Income before income taxes	60,767	42,902
Provision for income taxes	21,070	14,577
Net income	$ 39,697	$ 28,325
Net income per basic common share	$ 0.20	$ 0.15
Net income per diluted common share	$ 0.20	$ 0.14
Cash dividends per common share	$ 0.11	$ 0.11
Weighted average common shares outstanding basic	194,890	194,683
Weighted average common shares outstanding diluted	197,252	196,633
Retained earnings, beginning	$ 1,771,464	$ 1,711,929
Net income	39,697	28,325
Cash dividends and dividend equivalents	(21,945)	(21,752)
Reissuance of treasury stock	(15,011)	(2,329)
Retained earnings, ending	$ 1,774,205	$ 1,716,173

Refer to Notes to Consolidated Financial Statements

4

Table of Contents

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	13 Weeks Ended	
(In thousands)	April 28, 2012	April 30, 2011
Net income	$ 39,697	$ 28,325
Other comprehensive income:		
Foreign currency translation gain	1,873	5,501
Other comprehensive income	1,873	5,501
Comprehensive income	$ 41,570	$ 33,826

Refer to Notes to Consolidated Financial Statements

Table of Contents

AMERICAN EAGLE OUTFITTERS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	13 Weeks Ended	
(In thousands)	April 28, 2012	April 30, 2011
Operating activities:		
Net income	$ 39,697	$ 28,325
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	33,323	35,534
Share-based compensation	21,299	2,506
Provision for deferred income taxes	(2,772)	8,708
Tax benefit from share-based payments	4,422	256
Excess tax benefit from share-based payments	(2,643)	(139)
Foreign currency transaction gain	(145)	(219)
Changes in assets and liabilities:		
Merchandise inventory	2,345	(28,674)
Accounts receivable	2,865	5,445
Prepaid expenses and other	(347)	(30,327)
Other assets	(426)	(2,400)
Accounts payable	(46,852)	(7,301)
Unredeemed gift cards and gift certificates	(14,260)	(11,960)
Deferred lease credits	1,203	(174)
Accrued compensation and payroll taxes	(20,687)	(20,110)
Accrued income and other taxes	(9,498)	(18,749)
Accrued liabilities	5,154	90
Total adjustments	(27,019)	(67,514)
Net cash provided by (used for) operating activities	**12,678**	**(39,189)**
Investing activities:		
Capital expenditures for property and equipment	(24,831)	(37,744)
Acquisition of intangible assets	(220)	(33,151)
Purchase of available-for-sale securities	(3,051)	(111,199)
Sale of available-for-sale securities	20,119	48,887
Net cash used for investing activities	**(7,983)**	**(133,207)**
Financing activities:		
Payments on capital leases	(941)	(756)
Repurchase of common stock from employees	(4,100)	(2,181)
Net proceeds from stock options exercised	12,165	2,539
Excess tax benefit from share-based payments	2,643	139
Cash dividends paid	(21,524)	(21,430)
Net cash used for financing activities	**(11,757)**	**(21,689)**
Effect of exchange rates changes on cash	960	1,160
Net decrease in cash and cash equivalents	**(6,102)**	**(192,925)**
Cash and cash equivalents beginning of period	719,545	667,593

Cash and cash equivalents end of period	**$ 713,443**	**$ 474,668**
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	$ 34,782	$ 50,419
Cash paid during the period for interest	$ 33	$ 0

Refer to Notes to Consolidated Financial Statements

6

Table of Contents

AMERICAN EAGLE OUTFITTERS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Interim Financial Statements

The accompanying Consolidated Financial Statements of American Eagle Outfitters, Inc. (the Company) at April 28, 2012 and April 30, 2011 and for the 13 week periods ended April 28, 2012 and April 30, 2011 have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Certain notes and other information have been condensed or omitted from the interim Consolidated Financial Statements presented in this Quarterly Report on Form 10-Q. Therefore, these Consolidated Financial Statements should be read in conjunction with the Company s Fiscal 2011 Annual Report. In the opinion of the Company s management, all adjustments (consisting of normal recurring adjustments and those described in the footnotes that follow) considered necessary for a fair presentation have been included. The existence of subsequent events has been evaluated through the filing date of this Quarterly Report on Form 10-Q.

As used in this report, all references to we, our and the Company refer to American Eagle Outfitters, Inc. and its wholly owned subsidiaries. American Eagle Outfitters, American Eagle, AE and the AE Brand refer to our U.S. and Canadian American Eagle Outfitters stores. aerie re to our U.S. and Canadian aerie® by American Eagle® stores. 77kids refers to our 77kids by american eagle® stores. AEO Direct refers to our e-commerce operations, ae.com, aerie.com and 77kids.com.

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

2. Summary of Significant Accounting Policies

Principles of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. At April 28, 2012, the Company operated in one reportable segment.

Fiscal Year

The Company s financial year is a 52/53 week year that ends on the Saturday nearest to January 31. As used herein, Fiscal 2012 refers to the 53 week period ending February 2, 2013. Fiscal 2011 and Fiscal 2010 refer to the 52 week periods ended January 28, 2012 and January 29, 2011, respectively.

Estimates

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

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, *Presentation of Comprehensive Income* (ASU 2011-05). ASU 2011-05 requires that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income and the total of comprehensive income. For public entities, the amendments in ASU 2011-05 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and are to be applied retrospectively, with early adoption permitted. The Company adopted ASU 2011-05 on January 29, 2012 by presenting total other comprehensive income and its components as a separate statement following the Consolidated Statements of Operations and Retained Earnings.

Table of Contents

In September 2011, the FASB issued ASU 2011-08, *Testing Goodwill for Impairment* (ASU 2011-08). ASU 2011-08 permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. ASU 2011-08 applies to all companies that have goodwill reported in their financial statements. The provisions of ASU 2011-08 are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company adopted ASU 2011-08 on January 29, 2012 with no impact to the Consolidated Financial Statements.

Foreign Currency Translation

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

Revenue Recognition

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

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

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

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

The Company sells off end-of-season, overstock and irregular merchandise to a third-party. The proceeds from these sales are presented on a gross basis, with proceeds and cost of sell-offs recorded in net sales and cost of sales, respectively.

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

Cost of sales consists of merchandise costs, including design, sourcing, importing and inbound freight costs, as well as markdowns, shrinkage and certain promotional costs (collectively, merchandise costs) and buying, occupancy, and warehousing costs. Buying, occupancy and warehousing costs consist of compensation, employee benefit expenses and travel for our buyers and certain senior merchandising executives; rent and utilities related to our stores, corporate headquarters, distribution centers and other office space; freight from our distribution centers to the stores; compensation and supplies for our distribution centers, including purchasing, receiving and inspection costs; and shipping and handling costs related to our e-commerce operation. Merchandise profit is the difference between net sales and merchandise costs. Gross profit is the difference between net sales and cost of sales.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of compensation and employee benefit expenses, including salaries, incentives and related benefits associated with our stores and corporate headquarters. Selling, general and administrative expenses also include advertising costs, supplies for our stores and home office, communication costs, travel and entertainment, leasing costs and services purchased. Selling, general and administrative expenses

8

do not include compensation, employee benefit expenses and travel for our design, sourcing and importing teams, our buyers and our distribution centers as these amounts are recorded in cost of sales.

Other Income, Net

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

Other-than-Temporary Impairment

The Company evaluates its investments for impairment in accordance with ASC 320, *Investments Debt and Equity Securities* (ASC 320). ASC 320 provides guidance for determining when an investment is considered impaired, whether impairment is other-than-temporary, and measurement of an impairment loss. An investment is considered impaired if the fair value of the investment is less than its cost. If, after consideration of all available evidence to evaluate the realizable value of its investment, impairment is determined to be other-than-temporary, then an impairment loss is recognized in the Consolidated Statement of Operations equal to the difference between the investment s cost and its fair value. Additionally, ASC 320 requires additional disclosures relating to debt and equity securities both in the interim and annual periods as well as requires the Company to present total other-than-temporary impairment (OTTI) with an offsetting reduction for any non-credit loss impairment amount recognized in other comprehensive income (OCI). There was no net impairment loss recognized in earnings during the 13 weeks ended April 28, 2012 or April 30, 2011.

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

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

As of April 28, 2012, short-term investments include treasury bills with a maturity of greater than three months, but less than one year. It also includes auction rate securities (ARS) classified as available for sale that the Company expects to be redeemed at par within 12 months.

As of April 28, 2012, long-term investments include the Company s ARS Call Option related to investment sales during Fiscal 2010. Long-term investments are included within other assets on the Company s Consolidated Balance Sheets. The ARS Call Option expires on October 29, 2013.

Unrealized gains and losses on the Company s available-for-sale securities are excluded from earnings and are reported as a separate component of stockholders equity, within accumulated other comprehensive income, until realized. The components of OTTI losses related to credit losses, as defined by ASC 320, are considered by the Company to be realized and are recorded in earnings. When available-for-sale securities are sold, the cost of the securities is specifically identified and is used to determine any realized gain or loss.

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

Merchandise Inventory

Merchandise inventory is valued at the lower of average cost or market, utilizing the retail method. Average cost includes merchandise design and sourcing costs and related expenses. The Company records merchandise receipts at the time merchandise is delivered to the foreign shipping port by the manufacturer (FOB port). This is the point at which title and risk of loss transfer to the Company.

The Company reviews its inventory levels to identify slow-moving merchandise and generally uses markdowns to clear merchandise. Additionally, the Company estimates a markdown reserve for future planned permanent markdowns related to current inventory. Markdowns may occur when inventory exceeds customer demand for reasons of style, seasonal adaptation, changes in customer preference, lack of consumer acceptance of fashion items, competition, or if it is determined that the inventory in stock will not sell at its currently ticketed price. Such markdowns may have a material adverse impact on earnings, depending on the extent and amount of inventory affected. The Company also estimates a shrinkage reserve for the period between the last physical count and the balance sheet date. The estimate for the shrinkage reserve, based on historical results, can be affected by changes in merchandise mix and changes in actual shrinkage trends.

Table of Contents

Income Taxes

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

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

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

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

Property and Equipment

Property and equipment is recorded on the basis of cost with depreciation computed utilizing the straight-line method over the assets estimated useful lives. The useful lives of our major classes of assets are as follows:

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

In accordance with ASC 360, *Property, Plant, and Equipment* (ASC 360), the Company evaluates long-lived assets for impairment at the individual store level, which is the lowest level at which individual cash flows can be identified, for stores that have been open for a period of time sufficient to reach maturity. Impairment losses are recorded on long-lived assets used in operations when events and circumstances indicate that the assets are impaired and the undiscounted cash flows estimated to be generated by those assets are less than their carrying amounts. When events such as these occur, the impaired assets are adjusted to their estimated fair value and an impairment loss is recorded. No long-lived asset impairment charges were recorded during the 13 weeks ended April 28, 2012 or April 30, 2011.

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

Goodwill

The Company s goodwill is primarily related to the acquisition of its importing operations and Canadian business. In accordance with ASC 350, *Intangibles Goodwill and Other* (ASC 350), the Company evaluates goodwill for possible impairment on at least an annual basis and last performed an annual impairment test as of January 28, 2012. As a result of the Company s annual goodwill impairment test, the Company concluded that its goodwill was not impaired.

Intangible Assets

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

The Company evaluates intangible assets for impairment in accordance with ASC 350 when events or circumstances indicate that the carrying value of the asset may not be recoverable. Such an evaluation includes the estimation of undiscounted future cash flows to be generated by those assets. If the sum of the estimated future undiscounted cash flows are less than the carrying amounts of the assets, then the assets are impaired and are adjusted to their estimated fair value. No intangible asset impairment charges were recorded in the 13 weeks ended April 28, 2012 or April 30, 2011.

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

Gift Cards

The value of a gift card is recorded as a current liability upon purchase, and revenue is recognized when the gift card is redeemed for merchandise. The Company estimates gift card breakage and recognizes revenue in proportion to actual gift card redemptions as a component of net sales. The Company determines an estimated gift card breakage rate by continuously evaluating historical redemption data and the time when there is a remote likelihood that a gift card will be redeemed. During the 13 weeks ended April 28, 2012 and April 30, 2011, the Company recorded $1.9 million and $1.1 million, respectively, of revenue related to gift card breakage.

Deferred Lease Credits

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

Co-branded Credit Card and Customer Loyalty Program

The Company offers a co-branded credit card (the AEO Visa Card) and a private label credit card (the AEO Credit Card) under the American Eagle, aerie and 77kids brands. These credit cards are issued by a third-party bank (the Bank), and the Company has no liability to the Bank for bad debt expense, provided that purchases are made in accordance with the Bank s procedures. Once a customer is approved to receive the AEO Visa Card or the AEO Credit Card and the card is activated, the customer is eligible to participate in the credit card rewards program. Customers who make purchases at AE, aerie and 77kids earn discounts in the form of savings certificates when certain purchase levels are reached. Also, AEO Visa Card customers who make purchases at other retailers where the card is accepted earn additional discounts. Savings certificates are valid for 90 days from issuance.

Points earned under the credit card rewards program on purchases at AE, aerie and 77kids are accounted for by analogy to ASC 605-25, *Revenue Recognition, Multiple Element Arrangements* (ASC 605-25). The Company believes that points earned under its point and loyalty programs represent deliverables in a multiple element arrangement rather than a rebate or refund of cash. Accordingly, the portion of the sales revenue attributed to the award points is deferred and recognized when the award is redeemed or when the points expire. Additionally, credit card reward points earned on non-AE, aerie or 77kids purchases are accounted for in accordance with ASC 605-25. As the points are earned, a current liability is recorded for the estimated cost of the award, and the impact of adjustments is recorded in cost of sales.

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

Segment Information

In accordance with ASC 280, *Segment Reporting* (ASC 280), the Company has identified four operating segments (American Eagle Brand US and Canadian retail stores, aerie retail stores, 77kids retail stores and AEO Direct) that reflect the basis used internally to review performance and allocate resources. All of the operating segments have been aggregated and are presented as one reportable segment, as permitted by ASC 280.

Table of Contents

Reclassification

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

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

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

(*In thousands*)	April 28, 2012	January 28, 2012	April 30, 2011
Cash and cash equivalents:			
Cash	$ 625,398	$ 548,728	$ 251,002
Money-market	51,915	131,785	154,548
Commercial paper	19,999	29,998	43,830
Treasury bills	16,131	9,034	25,288
Total cash and cash equivalents	$ 713,443	$ 719,545	$ 474,668
Short-term investments:			
Treasury bills	$ 3,087	$ 19,999	$ 73,143
State and local government ARS	5,500	5,500	3,700
Corporate bonds			21,232
Term-deposits			18,743
Commercial paper			13,695
Total short-term investments	$ 8,587	$ 25,499	$ 130,513
Long-term investments:			
ARS Call Option	$ 727	$ 847	$ 415
State and local government ARS			5,500
Total long-term investments	$ 727	$ 847	$ 5,915
Total	$ 722,757	$ 745,891	$ 611,096

Proceeds from the sale of investments were $20.1 million and $48.9 million for the 13 weeks ended April 28, 2012 and April 30, 2011, respectively. The purchase of investments was $3.1 million and $111.2 million for the 13 weeks ended April 28, 2012 and April 30, 2011, respectively. As of April 28, 2012 and April 30, 2011, the fair value of all ARS investments approximated par, with no gross unrealized holding losses.

During Fiscal 2010, the Company liquidated ARS investments with $191.4 million of carrying value for proceeds of $177.5 million and a realized loss of $24.4 million (of which $10.9 million had previously been included in OCI on the Company s Consolidated Balance Sheets). The ARS securities sold during Fiscal 2010 included $119.7 million of par value ARS securities whereby the Company entered into a settlement agreement under which a financial institution (the purchaser) purchased the ARS at a discount to par, plus accrued interest. Additionally, under this agreement, the Company retained a right (the ARS Call Option), for a period ending October 29, 2013 to: (a) repurchase any or all of the ARS securities sold at the agreed upon purchase prices received from the purchaser plus accrued interest; and/or (b) receive additional proceeds from the purchaser upon certain redemptions of the ARS securities sold. The ARS Call Option is cancelable by the purchaser for additional cash consideration.

The Company is required to assess the value of the ARS Call Option at the end of each reporting period, with any changes in fair value recorded within the Consolidated Statement of Operations. Upon origination, the Company determined that the fair value was $0.4 million. The fair value of the ARS Call Option was included as an offsetting amount within the net loss on liquidation of $24.4 million referenced above. As of April 28, 2012, the Company determined that the remaining value of the ARS Call Option, which is classified as a long-term investment, was $0.7 million.

4. Fair Value Measurements

ASC 820, *Fair Value Measurement Disclosures* (ASC 820), defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. Fair value

12

Table of Contents

is defined under ASC 820 as the exit price associated with the sale of an asset or transfer of a liability in an orderly transaction between market participants at the measurement date.

Financial Instruments

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

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

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

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

As of April 28, 2012 and April 30, 2011, the Company held certain assets that are required to be measured at fair value on a recurring basis. These include cash equivalents and short and long-term investments, including ARS.

In accordance with ASC 820, the following table represents the Company s fair value hierarchy for its financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of April 28, 2012 and April 30, 2011:

		Fair Value Measurements at April 28, 2012		
(In thousands)	Carrying Amount	Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents:				
Cash	$ 625,398	$ 625,398	$	$
Money-market	51,915	51,915		
Commercial paper	19,999	19,999		
Treasury bills	16,131	16,131		
Total cash and cash equivalents	$ 713,443	$ 713,443	$	$
Short-term investments:				
Treasury bills	$ 3,087	$ 3,087	$	$
State and local government ARS	5,500			5,500
Total short-term investments	$ 8,587	$ 3,087	$	$ 5,500
Long-term investments:				
ARS Call Option	$ 727	$	$	$ 727
Total long-term investments	$ 727	$	$	$ 727
Total	$ 722,757	$ 716,530	$	$ 6,227

Table of Contents

		Fair Value Measurements at April 30, 2011		
(In thousands)	Carrying Amount	Quoted Market Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents:				
Cash	$ 251,002	$ 251,002	$	$
Money-market	154,548	154,548		
Commercial paper	43,830	43,830		
Treasury bills	25,288	25,288		

Total cash and cash equivalents