BIG 5 SPORTING GOODS Corp
Form 10-Q
October 29, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 28, 2014

OR

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

For the transition period from __________ to __________

Commission file number: 000-49850

BIG 5 SPORTING GOODS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**95-4388794**
(State or Other Jurisdiction of Incorporation or Organization)	**(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 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 ¨	Accelerated filer x
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

There were 22,173,745 shares of common stock, with a par value of $0.01 per share outstanding as of October 22, 2014.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

BIG 5 SPORTING GOODS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	September 28, 2014		December 29, 2013	
ASSETS				
Current assets:				
Cash	$	5,641	$	9,400
Accounts receivable, net of allowances of $132 and $105, respectively		9,381		16,301
Merchandise inventories, net		307,526		300,952
Prepaid expenses		6,159		6,356
Deferred income taxes		9,855		12,000
Total current assets		338,562		345,009
Property and equipment, net		75,524		75,608
Deferred income taxes		15,671		13,564
Other assets, net of accumulated amortization of $1,023 and $891, respectively		3,205		3,274
Goodwill		4,433		4,433
Total assets	$	437,395	$	441,888
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	93,857	$	104,826
Accrued expenses		61,376		69,923
Current portion of capital lease obligations		1,335		1,567
Total current liabilities		156,568		176,316
Deferred rent, less current portion		20,681		21,078
Capital lease obligations, less current portion		1,372		1,595
Long-term debt		55,381		43,018
Other long-term liabilities		9,341		9,111
Total liabilities		243,343		251,118
Commitments and contingencies				
Stockholders equity:				

Common stock, $0.01 par value, authorized 50,000,000 shares; issued 24,438,505 and 24,339,537 shares, respectively; outstanding 22,190,945 and 22,297,701 shares, respectively		245		244
Additional paid-in capital		110,184		109,901
Retained earnings		111,927		106,565
Less: Treasury stock, at cost; 2,247,560 and 2,041,836 shares, respectively		(28,304)		(25,940)
Total stockholders equity		194,052		190,770
Total liabilities and stockholders equity	$	437,395	$	441,888

See accompanying notes to unaudited condensed consolidated financial statements.

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BIG 5 SPORTING GOODS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	13 Weeks Ended		39 Weeks Ended	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
Net sales	$ 265,115	$ 259,121	$ 727,528	$ 745,286
Cost of sales	179,055	171,331	493,217	497,348
Gross profit	86,060	87,790	234,311	247,938
Selling and administrative expense	73,842	72,432	213,892	209,540
Operating income	12,218	15,358	20,419	38,398
Interest expense	386	395	1,191	1,266
Income before income taxes	11,832	14,963	19,228	37,132
Income taxes	4,366	5,825	7,167	14,376
Net income	$ 7,466	$ 9,138	$ 12,061	$ 22,756
Earnings per share:				
Basic	$ 0.34	$ 0.42	$ 0.55	$ 1.05
Diluted	$ 0.34	$ 0.41	$ 0.54	$ 1.03
Dividends per share	$ 0.10	$ 0.10	$ 0.30	$ 0.30
Weighted-average shares of common stock outstanding:				
Basic	21,926	21,933	21,964	21,700
Diluted	22,038	22,231	22,163	22,032

See accompanying notes to unaudited condensed consolidated financial statements.

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BIG 5 SPORTING GOODS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands, except share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock, At Cost	Total
Balance as of December 30, 2012	21,741,248	$ 238	$ 102,658	$ 87,464	$ (25,940)	$ 164,420
Net income				22,756		22,756
Dividends on common stock ($0.30 per share)				(6,616)		(6,616)
Issuance of nonvested share awards	127,020	1	(1)			
Exercise of share option awards	474,345	5	4,520			4,525
Share-based compensation			1,394			1,394
Tax benefit from share-based awards activity			1,446			1,446
Forfeiture of nonvested share awards	(9,695)					
Retirement of common stock for payment of withholding tax	(41,812)		(641)			(641)
Balance as of September 29, 2013	22,291,106	$ 244	$ 109,376	$ 103,604	$ (25,940)	$ 187,284
Balance as of December 29, 2013	22,297,701	$ 244	$ 109,901	$ 106,565	$ (25,940)	$ 190,770
Net income				12,061		12,061
Dividends on common stock ($0.30 per share)				(6,699)		(6,699)
Issuance of nonvested share awards	152,920	2	(2)			
Exercise of share option awards	10,525		63			63
Share-based compensation			1,451			1,451
Tax deficiency from share-based awards activity			(421)			(421)
Forfeiture of nonvested share awards	(11,550)					
Retirement of common stock for payment of withholding tax	(52,927)	(1)	(808)			(809)
Purchases of treasury stock	(205,724)				(2,364)	(2,364)
Balance as of September 28, 2014	22,190,945	$ 245	$ 110,184	$ 111,927	$ (28,304)	$ 194,052

See accompanying notes to unaudited condensed consolidated financial statements.

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BIG 5 SPORTING GOODS CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	39 Weeks Ended	
	September 28, 2014	**September 29, 2013**
Cash flows from operating activities:		
Net income	$ 12,061	$ 22,756
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	15,947	14,890
Impairment of store assets	756	72
Share-based compensation	1,451	1,394
Excess tax benefit related to share-based awards	(184)	(1,708)
Amortization of debt issuance costs	132	190
Deferred income taxes	38	(237)
Changes in operating assets and liabilities:		
Accounts receivable, net	6,920	3,899
Merchandise inventories, net	(6,574)	(17,589)
Prepaid expenses and other assets	134	(341)
Accounts payable	4,558	6,690
Accrued expenses and other long-term liabilities	(10,157)	(4,837)
Net cash provided by operating activities	25,082	25,179
Cash flows from investing activities:		
Purchases of property and equipment	(14,727)	(12,597)
Proceeds from solar energy rebate	100	
Net cash used in investing activities	(14,627)	(12,597)
Cash flows from financing activities:		
Principal borrowings under revolving credit facility	149,649	176,602
Principal payments under revolving credit facility	(137,286)	(186,124)
Changes in book overdraft	(15,733)	(3,334)
Principal payments under capital lease obligations	(1,233)	(1,352)
Proceeds from exercise of share option awards	63	4,525
Excess tax benefit related to share-based awards	184	1,708
Purchases of treasury stock	(2,345)	(75)
Tax withholding payments for share-based compensation	(809)	(641)
Dividends paid	(6,704)	(6,595)
Net cash used in financing activities	(14,214)	(15,286)

Net decrease in cash		(3,759)		(2,704)
Cash at beginning of period		9,400		7,635
Cash at end of period	$	5,641	$	4,931
Supplemental disclosures of non-cash investing and financing activities:				
Property and equipment acquired under capital leases	$	792	$	392
Property and equipment additions unpaid	$	4,077	$	4,948
Supplemental disclosures of cash flow information:				
Interest paid	$	1,096	$	1,070
Income taxes paid	$	4,558	$	12,122

See accompanying notes to unaudited condensed consolidated financial statements.

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BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Description of Business

Business

Big 5 Sporting Goods Corporation (the Company) is a leading sporting goods retailer in the western United States, operating 429 stores in 12 states as of September 28, 2014. 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 wholly-owned subsidiary, and Big 5 Services Corp., which is a wholly-owned subsidiary of Big 5 Corp. Big 5 Services Corp. provides a centralized operation for the issuance and administration of gift cards.

The accompanying interim unaudited condensed consolidated financial statements (Interim Financial Statements) of the Company and its wholly-owned subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and are presented in accordance with the requirements of Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these Interim Financial Statements do not include all of the information and notes required by GAAP for complete financial statements. These Interim Financial Statements should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended December 29, 2013 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 2014 is comprised of 52 weeks and ends on December 28, 2014. Fiscal year 2013 was comprised of 52 weeks and ended on December 29, 2013. The fiscal interim periods in fiscal 2014 and 2013 are each comprised of 13 weeks.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

Recently Issued Accounting Updates

In April 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity,* which includes amendments that change the requirements for reporting discontinued operations and require additional disclosures about discontinued operations. Under the new guidance, only disposals representing a strategic shift in operations that have, or will have, a major effect on the organization s operations and financial results should be presented as discontinued operations. Additionally, ASU No. 2014-08 requires expanded disclosures about discontinued operations that will provide financial statement users with more information about the assets, liabilities, income, and expenses of discontinued operations. The amendments in ASU No. 2014-08 will be applied prospectively to annual periods beginning on or after December 15, 2014, and interim periods within those years, with early adoption permitted. The Company adopted ASU No. 2014-08 in the first quarter of 2014, which did not have a material impact on the Company s Interim Financial Statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* which includes amendments that create Topic 606 and supersede the revenue recognition requirements in Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. In addition, the amendments supersede the cost guidance in Subtopic 605-35, *Revenue Recognition Construction-Type and Production-Type Contracts,* and create new Subtopic 340-40, *Other Assets and Deferred Costs Contracts with Customers.* In summary, the core principle of Topic 606 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 amendments in ASU No. 2014-09 are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company is evaluating the future impact of the issuance of ASU No. 2014-09.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements Going Concern (Subtopic 205-40) Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern*, which requires entities to evaluate their ability to continue as a going concern within one year after the date that the financial statements are issued. Disclosure is required if there is substantial doubt about an entity s ability to continue as a going concern. The guidance in ASU No. 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter, with early application permitted. The Company does not expect that the adoption of this ASU will have a material impact on the consolidated financial statements.

There have been no other recently issued accounting updates that had a material impact on the Company s Interim Financial Statements.

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BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

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 commitments and contingencies 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 asset retirements, litigation, self-insurance liabilities and employee benefits. Actual results could differ significantly from these estimates under different assumptions and conditions.

Revenue Recognition

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

Cash received from the sale of gift cards is recorded as a liability, and revenue is recognized upon the redemption of the gift card or when it is determined that the likelihood of redemption is remote (gift card breakage) and no liability to relevant jurisdictions exists. The Company determines the gift card breakage rate based upon historical redemption patterns and recognizes gift card breakage on a straight-line basis over the estimated gift card redemption period (20 quarters as of the end of the third quarter of fiscal 2014). The Company recognized approximately $110,000 and $326,000 in gift card breakage revenue for the 13 and 39 weeks ended September 28, 2014, respectively, compared to approximately $105,000 and $314,000 in gift card breakage revenue for the 13 and 39 weeks ended September 29, 2013, respectively.

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

Share-Based Compensation

The Company accounts for its share-based compensation in accordance with ASC 718, *Compensation Stock Compensation*. The Company recognizes compensation expense on a straight-line basis over the requisite service period using the fair-value method for share option awards, nonvested share awards and nonvested share unit awards granted with service-only conditions. See Note 10 to the Interim Financial Statements for a further discussion on share-based compensation.

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BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

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 market using the weighted-average cost method that approximates the first-in, first-out 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 market value. Because of its merchandise mix, the Company has not historically experienced significant occurrences of obsolescence.

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

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

Valuation of Long-Lived Assets

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

Long-lived assets are reviewed for recoverability at the lowest level in which there are identifiable cash flows (asset group), usually at the store level. Each store typically requires investments of approximately $0.4 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 profit and operating expense for each store under consideration for impairment. The estimates of future cash flows involve management judgment and are based upon assumptions about expected future operating performance. Assumptions used in these forecasts are consistent with internal planning, and take into consideration, among other factors, 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.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

Leases and Deferred Rent

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

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

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

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

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

(3) Impairment of Long-Lived Assets

For the 39 weeks ended September 28, 2014 and September 29, 2013, the Company recognized pre-tax non-cash impairment charges of $0.8 million and $0.1 million, respectively, related to certain underperforming stores. These impairment charges are included in selling and administrative expense in the accompanying interim unaudited condensed consolidated statements of operations.

BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

(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 are reduced to their estimated fair values.

During the 39 weeks ended September 28, 2014 and September 29, 2013, the Company s only significant assets or liabilities measured at fair value on a nonrecurring basis subsequent to their initial recognition were certain assets subject to long-lived asset impairment. The Company classified these fair value measurements as Level 3, in accordance with ASC 820, *Fair Value Measurement*.

(5) Accrued Expenses

The major components of accrued expenses are as follows:

	September 28, 2014	December 29, 2013
	(In thousands)	
Payroll and related expense	$ 19,101	$ 23,240
Occupancy expense	9,670	9,392
Sales tax	7,014	10,110
Self-insurance liabilities	4,467	4,357
Advertising	2,891	5,734
Other	18,233	17,090
Accrued expenses	$ 61,376	$ 69,923

(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.

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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).

On October 31, 2011, the Company entered into a First Amendment to Credit Agreement (First Amendment) and amended certain provisions of the Credit Agreement. After the First Amendment, those loans designated as LIBO rate loans bore 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 bore 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 was as set forth below as a function of Average Daily Excess Availability for the preceding fiscal quarter.

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

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

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BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(continued)

On December 19, 2013, the Company entered into a Second Amendment to Credit Agreement (Second Amendment) and amended certain provisions of the Credit Agreement. Following the Second Amendment, 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.

Level	Average Daily Excess Availability	LIBO Rate Applicable Margin	Base Rate Applicable Margin
I	Greater than or equal to $100,000,000	1.25%	0.25%
II	Less than $100,000,000 but greater than or equal to $40,000,000	1.50%	0.50%
III	Less than $40,000,000	1.75%	0.75%

The Second Amendment further reduced the commitment fee assessed on the unused portion of the Credit Facility to 0.25% per annum, and reduced certain fees for letters of credit.

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 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.

The Company had long-term revolving credit borrowings of $55.4 million and $43.0 million as of September 28, 2014 and December 29, 2013, respectively. Total remaining borrowing availability, after subtracting letters of credit, was $83.9 million and $96.1 million as of September 28, 2014 and December 29, 2013, respectively.

BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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(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 September 28, 2014 and December 29, 2013, there was no valuation allowance as the deferred income tax assets were more likely than not to be realized.

The Company files a consolidated federal income tax return and files tax returns in various state and local jurisdictions. The statutes of limitations for consolidated federal income tax returns are open for fiscal years 2011 and after, and state and local income tax returns are open for fiscal years 2009 and after.

Effective January 2, 2013, The American Taxpayer Relief Act of 2012 was enacted, which contained provisions that retroactively reinstated the work opportunity tax credit (WOTC) and the 15-year cost recovery life of qualified leasehold improvements from January 1, 2012 through December 31, 2013. As a result of this legislation, the Company applied WOTC of approximately $0.3 million to its fiscal 2013 first quarter tax provision for amounts generated in 2012, resulting in a reduction to its estimated effective tax rate for the 2013 first quarter of 137 basis points. Also as a result of this legislation, the Company increased its 2012 federal depreciation deduction by approximately $2.8 million, which resulted in a reduction to deferred tax assets and income taxes payable by approximately $1.1 million in the first quarter of fiscal 2013.

As of September 28, 2014 and December 29, 2013, the Company had no unrecognized tax benefits that, if recognized, would affect the Company s effective income tax rate over the next 12 months. The Company s policy is to recognize interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expense. As of September 28, 2014 and December 29, 2013, the Company had no accrued interest or penalties.

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(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 potentially dilutive effect of outstanding share option awards, nonvested share awards and nonvested share unit awards.

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

	13 Weeks Ended		39 Weeks Ended	
	September 28, 2014	September 29, 2013	September 28, 2014	September 29, 2013
	(In thousands, except per share data)			
Net income	$ 7,466	$ 9,138	$ 12,061	$ 22,756
Weighted-average shares of common stock outstanding:				
Basic	21,926	21,933	21,964	21,700
Dilutive effect of common stock equivalents arising from share option, nonvested share and nonvested share unit awards	112	298	199	332
Diluted	22,038	22,231	22,163	22,032
Basic earnings per share	$ 0.34	$ 0.42	$ 0.55	$ 1.05
Diluted earnings per share	$ 0.34	$ 0.41	$ 0.54	$ 1.03

The computation of diluted earnings per share for the 13 weeks ended September 28, 2014, the 39 weeks ended September 28, 2014, the 13 weeks ended September 29, 2013 and the 39 weeks ended September 29, 2013 does not include share option awards in the amounts of 507,259, 528,123, 474,271 and 779,443, respectively, that were outstanding and antidilutive (i.e., including such share option awards would result in higher earnings per share), since the exercise prices of these share option awards exceeded the average market price of the Company s common shares.

Additionally, the computation of diluted earnings per share for the 13 weeks ended September 28, 2014, the 39 weeks ended September 28, 2014 and the 39 weeks ended September 29, 2013 does not include nonvested share awards and nonvested share unit awards in the amounts of 260,691, 1,320 and 7,648 shares, respectively, that were outstanding and antidilutive, since the

BIG 5 SPORTING GOODS CORPORATION

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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. No nonvested share awards or nonvested share unit awards were antidilutive for the 13 weeks ended September 29, 2013.

(9) Commitments and Contingencies

The Company was served on the following dates with the following nine complaints, each of which was brought as a purported class action on behalf of persons who made purchases at the Company s stores in California using credit cards and were requested or required to provide personal identification information at the time of the transaction: (1) on February 22, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Maria Eugenia Saenz Valiente v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455049; (2) on February 22, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Scott Mossler v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455477; (3) on February 28, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Yelena Matatova v. Big 5 Sporting Goods Corporation*, et al., Case No. BC455459; (4) on March 8, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Neal T. Wiener v. Big 5 Sporting Goods Corporation*, et al., Case No. BC456300; (5) on March 22, 2011, a complaint filed in the California Superior Court in the County of San Francisco, entitled *Donna Motta v. Big 5 Sporting Goods Corporation*, et al., Case No. CGC-11-509228; (6) on March 30, 2011, a complaint filed in the California Superior Court in the County of Alameda, entitled *Steve Holmes v. Big 5 Sporting Goods Corporation*, et al., Case No. RG11563123; (7) on March 30, 2011, a complaint filed in the California Superior Court in the County of San Francisco, entitled *Robin Nelson v. Big 5 Sporting Goods Corporation*, et al., Case No. CGC-11-508829; (8) on April 8, 2011, a complaint filed in the California Superior Court in the County of San Joaquin, entitled *Pamela B. Smith v. Big 5 Sporting Goods Corporation*, et al., Case No. 39-2011-00261014-CU-BT-STK; and (9) on May 31, 2011, a complaint filed in the California Superior Court in the County of Los Angeles, entitled *Deena Gabriel v. Big 5 Sporting Goods Corporation*, et al., Case No. BC462213. On June 16, 2011, the Judicial Council of California issued an Order Assigning Coordination Trial Judge designating the California Superior Court in the County of Los Angeles as having jurisdiction to coordinate and to hear all nine of the cases as Case No. JCCP4667. On October 21, 2011, the plaintiffs collectively filed a Consolidated Amended Complaint, alleging violations of the California Civil Code, negligence, invasion of privacy and unlawful intrusion. The plaintiffs allege, among other things, that customers making purchases with credit cards at the Company s stores in California were improperly requested to provide their zip code at the time of such purchases. The plaintiffs seek, on behalf of the class members, the following: statutory penalties; attorneys fees; expenses; restitution of property; disgorgement of profits; and injunctive relief. In an effort to negotiate a settlement of this litigation, the Company and plaintiffs engaged in Mandatory Settlement Conferences conducted by the court on February 6, 2013, February 19, 2013, April 2, 2013, September 12, 2013, and September 20, 2013, and also engaged in mediation conducted by a third party mediator on July 15, 2013. As a result of the foregoing, the parties agreed to settle the lawsuit. On March 23, 2014, the court granted preliminary approval of the settlement. The court has scheduled a hearing for November 10, 2014, to consider granting final approval of the settlement. Under the terms of the

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BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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settlement, the Company agreed that class members who submit valid and timely claim forms will receive either a $25 gift card (with proof of purchase) or a $10 merchandise voucher (without proof of purchase). Additionally, the Company agreed to pay plaintiff s attorneys fees and costs awarded by the court, enhancement payments to the class representatives and claims administrator s fees. Under the settlement, if the total amount paid by the Company for the class payout, class representative enhancement payments and claims administrator s fees is less than $1.0 million, then the Company will issue merchandise vouchers to a charity for the balance of the deficiency in the manner provided in the settlement agreement. The Company s estimated total cost pursuant to this settlement is reflected in a legal settlement accrual recorded in the third quarter of fiscal 2013. The Company admitted no liability or wrongdoing with respect to the claims set forth in the lawsuit. Once final approval is granted, the settlement will constitute a full and complete settlement and release of all claims related to the lawsuit. Based on the terms of the settlement agreement, the Company currently believes that settlement of this litigation will not have a material negative impact on the Company s results of operations or financial condition. However, if the settlement is not finally approved by the court, the Company intends to defend this litigation vigorously. If the settlement is not finally approved by the court and this litigation is settled or resolved unfavorably to the Company, this litigation and the costs of defending it could have a material negative impact on the Company s results of operations or financial condition.

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

(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 on June 14, 2011 (the Plan), and accounts for its share-based compensation in accordance with ASC 718. The Company recognized $0.5 million and $1.5 million in share-based compensation expense for the 13 weeks and 39 weeks ended September 28, 2014, respectively, compared to $0.5 million and $1.4 million in share-based compensation expense for the 13 weeks and 39 weeks ended September 29, 2013, 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. In the 39 weeks ended September 28, 2014 and September 29, 2013, the Company granted 18,000 and 30,500 share option awards, respectively. The weighted-average grant-date fair value per option for share option awards granted in the 39 weeks ended September 28, 2014 and September 29, 2013 was $4.80 and $8.37, respectively.

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BIG 5 SPORTING GOODS CORPORATION

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A summary of the status of the Company s share option awards is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
Outstanding at December 29, 2013	989,130	$ 17.83		
Granted	18,000	11.93		
Exercised	(10,525)	5.99		
Forfeited or Expired	(253,700)	24.12		
Outstanding at September 28, 2014	742,905	$ 15.71	3.20	$ 777,818
Exercisable at September 28, 2014	679,905	$ 16.01	2.70	$ 723,818
Vested and Expected to Vest at September 28, 2014	742,121	$ 15.72	3.20	$ 777,551

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based upon the Company s closing stock price of $9.69 as of September 28, 2014, which would have been received by the share option award holders had all share option award holders exercised their share option awards as of that date.

The total intrinsic value of share option awards exercised for the 39 weeks ended September 28, 2014 and September 29, 2013 was approximately $0.1 million and $5.0 million, respectively. The total cash received from employees as a result of employee share option award exercises for the 39 weeks ended September 28, 2014 and September 29, 2013 was approximately $63,000 and $4.5 million, respectively. The actual tax benefit realized for the tax deduction from share option award exercises of share-based compensation awards in the 39 weeks ended September 28, 2014 and September 29, 2013 totaled $45,000 and $2.0 million, respectively.

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

39 Weeks Ended

	September 28, 2014	September 29, 2013
Risk-free interest rate	1.8%	1.4%
Expected term	5.8 years	6.9 years
Expected volatility	57.0%	57.5%
Expected dividend yield	3.3%	2.3%

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected term of the option award; the expected term represents the weighted-average period of time that option awards granted are expected to be

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BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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outstanding giving consideration to vesting schedules and historical participant exercise behavior; the expected volatility is based upon historical volatility of the Company s common stock; and the expected dividend yield is based upon the Company s current dividend rate and future expectations.

As of September 28, 2014, there was $0.3 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 2.4 years.

Nonvested Share Awards and Nonvested Share Unit Awards

Nonvested share awards and nonvested share unit awards granted by the Company vest from the date of grant in four equal annual installments of 25% per year. Nonvested share awards are delivered to the recipient upon their vesting. With respect to nonvested share unit awards, vested shares will be delivered to the recipient on the tenth business day of January following the year in which the recipient s service to the Company is terminated. The total fair value of nonvested share awards which vested during the 39 weeks ended September 28, 2014 and September 29, 2013 was $2.1 million and $1.8 million, respectively. The total fair value of nonvested share unit awards which vested during the 39 weeks ended September 28, 2014 and September 29, 2013 was $0.1 million and $38,000, respectively.

The Company granted 152,920 and 127,020 nonvested share awards in the 39 weeks ended September 28, 2014 and September 29, 2013, respectively. The weighted-average grant-date fair value per share of the Company s nonvested share awards granted in the 39 weeks ended September 28, 2014 and September 29, 2013 was $15.14 and $15.56, respectively.

The following table details the Company s nonvested share awards activity for the 39 weeks ended September 28, 2014:

	Shares	Weighted-Average Grant-Date Fair Value
Balance as of December 29, 2013	333,770	$ 12.38
Granted	152,920	15.14
Vested	(137,615)	12.67
Forfeited	(11,550)	13.38
Balance as of September 28, 2014	337,525	$ 13.48

To satisfy employee minimum statutory tax withholding requirements for nonvested share awards that vest, the Company withholds and retires a portion of the vesting common shares, unless an employee elects to pay cash. In the 39 weeks ended September 28, 2014, the Company withheld 52,927 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.

BIG 5 SPORTING GOODS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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In the 39 weeks ended September 28, 2014 and September 29, 2013, the Company granted 12,000 and 12,000 nonvested share unit awards, respectively. The weighted-average grant-date fair value per share of the Company s nonvested share unit awards granted in the 39 weeks ended September 28, 2014 and September 29, 2013 was $11.93 and $20.29, respectively. The weighted-average grant-date fair value of nonvested share awards and nonvested share unit awards is the quoted market price of the Company s common stock on the date of grant.

As of September 28, 2014, there was $3.5 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 2.5 years and 2.7 years for nonvested share awards and nonvested share unit awards, respectively.

(11) Subsequent Event

In the fourth quarter of fiscal 2014, the Company s Board of Directors declared a quarterly cash dividend of $0.10 per share of outstanding common stock, which will be paid on December 15, 2014 to stockholders of record as of December 1, 2014.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Big 5 Sporting Goods Corporation

El Segundo, California

We have reviewed the accompanying condensed consolidated balance sheet of Big 5 Sporting Goods Corporation and subsidiaries (the Corporation) as of September 28, 2014, and the related condensed consolidated statements of operations for the 13 and 39 weeks ended September 28, 2014 and September 29, 2013, and of stockholders equity and cash flows for the 39 weeks ended September 28, 2014 and September 29, 2013. These interim financial statements are the responsibility of the Corporation s management.

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

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Big 5 Sporting Goods Corporation and subsidiaries as of December 29, 2013, and the related consolidated statements of operations, stockholders equity, and cash flows for the year then ended (not presented herein); and in our report dated February 26, 2014, 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 December 29, 2013 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
October 29, 2014

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

The following discussion and analysis of the Big 5 Sporting Goods Corporation (we, our, us) financial condition and results of operations includes information with respect to our plans and strategies for our business and should be read in conjunction with our interim unaudited condensed consolidated financial statements and related notes (Interim Financial Statements) included herein and our consolidated financial statements and related notes, and *Management s Discussion and Analysis of Financial Condition and Results of Operations* contained in our Annual Report on Form 10-K for the fiscal year ended December 29, 2013.

Overview

We are a leading sporting goods retailer in the western United States, operating 429 stores in 12 states under the name Big 5 Sporting Goods as of September 28, 2014. 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 fo