ABERCROMBIE & FITCH CO /DE/
Form 10-Q
September 09, 2013
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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 August 3, 2013

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 1-12107

ABERCROMBIE & FITCH CO.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	31-1469076 (I.R.S. Employer Identification No.)
6301 Fitch Path, New Albany, Ohio (Address of principal executive offices)	43054 (Zip Code)

Registrant's telephone number, including area code (614) 283-6500

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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. x Yes ¨ No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). x Yes ¨ No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	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 x No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class A Common Stock	Outstanding at August 30, 2013
$.01 Par Value	76,392,808 Shares

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ABERCROMBIE & FITCH CO.
CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME (LOSS)
(Thousands, except share and per share amounts)
(Unaudited)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
		(Restated - see Note 3)		(Restated - see Note 3)
NET SALES	$945,698	$951,407	$1,784,467	$1,872,625
Cost of Goods Sold	341,576	358,956	627,178	739,082
GROSS PROFIT	604,122	592,451	1,157,289	1,133,543
Stores and Distribution Expense	471,722	458,085	920,848	913,817
Marketing, General and Administrative Expense	117,646	111,293	236,425	228,182
Other Operating Income, Net	(4,411)	(1,933)	(5,228)	(4,519)
OPERATING INCOME (LOSS)	19,165	25,006	5,244	(3,937)
Interest Expense, Net	1,750	1,546	3,378	2,636
INCOME (LOSS) BEFORE TAXES	17,415	23,460	1,866	(6,573)
Tax Expense (Benefit)	6,045	6,409	(2,301)	(2,319)
NET INCOME (LOSS)	$11,370	$17,051	$4,167	$(4,254)
NET INCOME (LOSS) PER SHARE:				
BASIC	$0.15	$0.21	$0.05	$(0.05)
DILUTED	$0.14	$0.20	$0.05	$(0.05)
WEIGHTED-AVERAGE SHARES OUTSTANDING:				
BASIC	77,382	82,555	77,853	83,574
DILUTED	79,267	83,441	79,709	83,574
DIVIDENDS DECLARED PER SHARE	$0.200	$0.175	$0.400	$0.350
OTHER COMPREHENSIVE INCOME (LOSS)				
Foreign Currency Translation Adjustments	$(2,229)	$(19,688)	$(19,489)	$(16,501)
Unrealized Gain (Loss) on Derivative Financial Instruments, net of taxes of $(177) and $(724) for the thirteen-week periods ended August 3, 2013 and July 28, 2012, respectively and $(1,180) and $212 for the twenty-six week periods ended August 3, 2013 and July 28, 2012, respectively.	364	9,231	9,859	2,086
Other Comprehensive Income (Loss)	$(1,865)	$(10,457)	$(9,630)	$(14,415)
COMPREHENSIVE INCOME (LOSS)	$9,505	$6,594	$(5,463)	$(18,669)

The accompanying Notes are an integral part of these Consolidated Financial Statements

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ABERCROMBIE & FITCH CO.
CONSOLIDATED BALANCE SHEETS
(Thousands, except par value amounts)

	(unaudited) August 3, 2013	February 2, 2013
ASSETS		
CURRENT ASSETS:		
Cash and Equivalents	$335,023	$643,505
Receivables	92,886	99,622
Inventories	633,483	426,962
Deferred Income Taxes	47,057	32,558
Other Current Assets	107,621	105,177
TOTAL CURRENT ASSETS	1,216,070	1,307,824
PROPERTY AND EQUIPMENT, NET	1,252,841	1,308,232
OTHER ASSETS	373,932	371,345
TOTAL ASSETS	$2,842,843	$2,987,401
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts Payable	$195,728	$140,396
Accrued Expenses	291,772	398,868
Deferred Lease Credits	36,994	39,054
Income Taxes Payable	39,733	112,483
Short-Term Portion of Borrowings	15,000	—
TOTAL CURRENT LIABILITIES	579,227	690,801
LONG-TERM LIABILITIES:		
Deferred Lease Credits	157,956	168,397
Long-Term Portion of Borrowings	127,500	—
Leasehold Financing Obligations	61,126	63,942
Other Liabilities	233,369	245,993
TOTAL LONG-TERM LIABILITIES	579,951	478,332
STOCKHOLDERS' EQUITY:		
Class A Common Stock - $0.01 par value: 150,000 shares authorized and 103,300 shares issued at each of August 3, 2013 and February 2, 2013	1,033	1,033
Paid-In Capital	410,412	403,271
Retained Earnings	2,536,499	2,567,261
Accumulated Other Comprehensive Income (Loss), net of tax	(22,918)	(13,288)
Treasury Stock, at Average Cost - 26,915 and 24,855 shares at August 3, 2013 and February 2, 2013, respectively	(1,241,361)	(1,140,009)
TOTAL STOCKHOLDERS' EQUITY	1,683,665	1,818,268
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$2,842,843	$2,987,401

The accompanying Notes are an integral part of these Consolidated Financial Statements

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ABERCROMBIE & FITCH CO.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Thousands)
(Unaudited)

	Twenty-Six Weeks Ended	
	August 3, 2013	July 28, 2012 (Restated - see Note 3)
OPERATING ACTIVITIES:		
Net Income (Loss)	$4,167	$(4,254)
Impact of Other Operating Activities on Cash Flows:		
Depreciation and Amortization	120,313	109,347
Loss on Disposal / Write-off of Assets	2,338	5,184
Lessor Construction Allowances	13,296	8,394
Amortization of Deferred Lease Credits	(20,940)	(23,339)
Deferred Taxes	(26,227)	(34,839)
Share-Based Compensation	26,950	25,450
Changes in Assets and Liabilities:		
Inventories	(207,674)	(15,765)
Accounts Payable and Accrued Expenses	(48,055)	(44,329)
Income Taxes	(73,681)	(43,495)
Other Assets and Liabilities	793	(6,645)
NET CASH USED FOR OPERATING ACTIVITIES	(208,720)	(24,291)
INVESTING ACTIVITIES:		
Capital Expenditures	(81,231)	(199,958)
Proceeds from Sales of Marketable Securities	—	80,693
Other Investing	(5,312)	(6,048)
NET CASH USED FOR INVESTING ACTIVITIES	(86,543)	(125,313)
FINANCING ACTIVITIES:		
Proceeds from Share-Based Compensation	191	106
Excess Tax Benefit from Share-Based Compensation	2,370	1,054
Purchase of Treasury Stock	(115,806)	(161,215)
Repayments of Borrowings	(7,500)	—
Proceeds from Borrowings	150,000	75,000
Change in Outstanding Checks and Other	(3,756)	(3,457)
Dividends Paid	(31,364)	(29,260)
NET CASH USED FOR FINANCING ACTIVITIES	(5,865)	(117,772)
EFFECT OF EXCHANGE RATES ON CASH	(7,354)	(3,966)
NET DECREASE IN CASH AND EQUIVALENTS:	(308,482)	(271,342)
Cash and Equivalents, Beginning of Period	643,505	583,495
CASH AND EQUIVALENTS, END OF PERIOD	$335,023	$312,153
SIGNIFICANT NON-CASH INVESTING ACTIVITIES:		
Change in Accrual for Construction in Progress	$(598)	$6,728

The accompanying Notes are an integral part of these Consolidated Financial Statements

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ABERCROMBIE & FITCH CO.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

Abercrombie & Fitch Co. (“A&F”), through its wholly-owned subsidiaries (collectively, A&F and its wholly-owned subsidiaries are referred to as the “Company”), is a specialty retailer of high-quality, casual apparel for men, women and kids with an active, youthful lifestyle.

The accompanying Consolidated Financial Statements include the historical financial statements of, and transactions applicable to, the Company and reflect its assets, liabilities, results of operations and cash flows.

The Company’s fiscal year ends on the Saturday closest to January 31. Fiscal years are designated in the consolidated financial statements and notes by the calendar year in which the fiscal year commences. All references herein to “Fiscal 2013” represent the 52-week fiscal year that will end on February 1, 2014, and to “Fiscal 2012” represent the 53-week fiscal year that ended February 2, 2013.

The Consolidated Financial Statements as of August 3, 2013 and for the thirteen and twenty-six week periods ended August 3, 2013 and July 28, 2012 are unaudited and are presented pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, these Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto contained in A&F’s Annual Report on Form 10-K for Fiscal 2012 filed on April 2, 2013. The February 2, 2013 consolidated balance sheet data were derived from audited consolidated financial statements, but do not include all disclosures required by accounting principles generally accepted in the United States of America (“U.S. GAAP”).

In the opinion of management, the accompanying Consolidated Financial Statements reflect all adjustments (which are of a normal recurring nature) necessary to state fairly, in all material respects, the financial position and results of operations and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for Fiscal 2013.

Certain prior period amounts have been reclassified to conform to current year presentation. In addition, the thirteen and twenty-six week periods ended August 3, 2013 include the correction of certain errors relating to prior periods. The thirteen week period ended August 3, 2013 includes a reduction of stores and distribution expense of $4.5 million related to prior periods. The twenty-six week period ended August 3, 2013 includes a reduction of pre-tax expense of $5.5 million, consisting of $4.4 million of stores and distribution expense and $1.1 million in gross margin, and an unrelated tax charge of $1.2 million related to prior periods. The Company does not believe these corrections were material to any current or prior interim or annual periods that were affected.

The Consolidated Financial Statements as of August 3, 2013 and for the thirteen and twenty-six week periods ended August 3, 2013 and July 28, 2012 included herein have been reviewed by PricewaterhouseCoopers LLP, an independent registered public accounting firm, and the report of such firm follows the Notes to Consolidated Financial Statements.

PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (the “Act”) for their report on the consolidated financial statements because their report is not a “report” or a “part” of a registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

2. SEGMENT REPORTING

The Company determines its segments on the same basis that it uses to allocate resources and assess performance. All of the Company’s segments sell a similar group of products—casual sportswear apparel, personal care products and accessories for men, women and kids and bras, underwear and sleepwear for girls. The Company has three reportable segments: U.S. Stores, International Stores, and Direct-to-Consumer. Corporate functions, interest income and expense, and other income and expense are evaluated on a consolidated basis and are not allocated to the Company’s segments, and therefore are included in Other.

The U.S. Stores reportable segment includes the results of store operations in the United States and Puerto Rico. The International Stores reportable segment includes the results of store operations in Canada, Europe, Asia and Australia. The Direct-to-Consumer reportable segment includes the results of operations directly associated with on-line operations, both domestic and international.

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Operating income is the primary measure of profit the Company uses to make decisions regarding the allocation of resources to its segments. For the U.S. Stores and International Stores reportable segments, operating income is defined as aggregate income directly attributable to individual stores on a four-wall basis plus sell-off of excess merchandise to authorized third-party resellers. Four-wall operating income includes: net sales, cost of merchandise, selling payroll and related costs, rent, utilities, depreciation, repairs and maintenance, supplies and packaging and other store sales-related expenses including credit card and bank fees and taxes. Operating income also reflects pre-opening charges related to stores not yet in operation. For the Direct-to-Consumer reportable segment, operating income is defined as aggregate income attributable to the direct-to-consumer business: net sales, shipping and handling revenue, call center costs, fulfillment and shipping expense, charge card fees and direct-to-consumer operations management and support expenses. The U.S. Stores, International Stores and Direct-to-Consumer segments exclude marketing, general and administrative expense; store management and support functions such as regional and district management and other functions not dedicated to an individual store; and distribution center costs. All costs excluded from the three reportable segments are included in Other.

The following table provides the Company's segment information as of, and for the thirteen and twenty-six week periods ended August 3, 2013 and July 28, 2012.

	U.S. Stores	International Stores	Direct-to-Consumer Operations	Segment Total	Other[1]	Total
	(in thousands):					
Thirteen Weeks Ended August 3, 2013						
Net Sales	$504,674	$286,727	$154,297	$ 945,698	$—	$945,698
Operating Income (Loss)	58,871	66,647	55,008	180,526	(161,361)	19,165
Thirteen Weeks Ended July 28, 2012						
Net Sales	$562,105	$261,625	$127,677	$ 951,407	$—	$951,407
Operating Income (Loss) [2]	70,658	74,302	43,456	188,416	(163,410)	25,006

	U.S. Stores	International Stores	Direct-to-Consumer Operations	Segment Total	Other[1]	Total
	(in thousands):					
Twenty-Six Weeks Ended August 3, 2013						
Net Sales	953,290	544,161	287,016	1,784,467	—	1,784,467
Operating Income (Loss)	98,693	120,180	111,191	330,064	(324,820)	5,244
Twenty-Six Weeks Ended July 28, 2012						
Net Sales	1,105,986	490,733	275,906	1,872,625	—	1,872,625
Operating Income (Loss) [2]	114,612	124,601	88,754	327,967	(331,904)	(3,937)

(1) Includes corporate functions such as Design, Merchandising, Sourcing, Planning, Allocation, Store Management and Support, Marketing, Distribution Center Operations, Information Technology, Real Estate, Finance, Legal, Human Resources and other corporate overhead. Operating Income includes: marketing, general and administrative expense; store management and support functions such as regional and district management and other functions not dedicated to an individual store; and distribution center costs.

(2)

Results reported above have been adjusted based on the change in accounting principle as noted in Note 3, “CHANGE IN ACCOUNTING PRINCIPLE”.

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Geographic Information

Financial information relating to the Company’s operations by geographic area is as follows:

Net Sales:

Net sales includes net merchandise sales through stores and direct-to-consumer operations, including shipping and handling revenue. Net sales are reported by geographic area based on the location of the customer.

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
(in thousands):	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
United States	$597,259	$648,017	$1,132,156	$1,292,277
Europe	267,764	250,339	504,418	469,925
Other	80,675	53,051	147,893	110,423
Total	$945,698	$951,407	$1,784,467	$1,872,625

3. CHANGE IN ACCOUNTING PRINCIPLE

The Company elected to change its method of accounting for inventory from the lower of cost or market utilizing the retail method to the lower of cost or market under the weighted-average cost method effective February 2, 2013. In accordance with generally accepted accounting principles, all periods have been retroactively adjusted to reflect the period-specific effects of the change to the weighted-average cost method. The Company believes that accounting under the weighted-average cost method is preferable as it better aligns with the Company's focus on realized selling margin and improves the comparability of the Company's financial results with those of its competitors. Additionally, it will improve the matching of cost of goods sold with the related net sales and reflect the acquisition cost of inventory outstanding at each balance sheet date.

As a result of the retroactive application of the change in accounting for inventory, the following items in the Company's Consolidated Statements of Operations and Comprehensive Income (Loss) and Consolidated Statements of Cash Flows have been restated:

Thirteen Weeks Ended July 28, 2012 (in thousands, except per share data)

	As Reported	Effect of Change	As Restated
Net Sales	$951,407	$—	$951,407
Cost of Goods Sold	357,000	1,956	358,956
Gross Profit	594,407	(1,956)	592,451
Operating Income (Loss)	26,962	(1,956)	25,006
Income (Loss) Before Taxes	25,416	(1,956)	23,460
Tax Expense (Benefit)	9,897	(3,488)	6,409
Net Income (Loss)	15,519	1,532	17,051
Net Income (Loss) Per Share:			
Basic	$0.19	$0.02	$0.21
Diluted	$0.19	$0.01	$0.20
Foreign Currency Translation Adjustments	(19,452)	(236)	(19,688)
Other Comprehensive Income (Loss)	(10,221)	(236)	(10,457)
Comprehensive Income (Loss)	5,298	1,296	6,594

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Twenty-Six Weeks Ended July 28, 2012 (in thousands, except per share data)

	As Reported	Effect of Change	As Restated
Net Sales	$1,872,625	$—	$1,872,625
Cost of Goods Sold	701,859	37,223	739,082
Gross Profit	1,170,766	(37,223)	1,133,543
Operating Income (Loss)	33,286	(37,223)	(3,937)
Income (Loss) Before Taxes	30,650	(37,223)	(6,573)
Tax Expense (Benefit)	12,146	(14,465)	(2,319)
Net Income (Loss)	18,504	(22,758)	(4,254)
Net Income (Loss) Per Share:			
Basic	$0.22	$(0.27)	$(0.05)
Diluted	$0.22	$(0.27)	$(0.05)
Foreign Currency Translation Adjustments	(16,068)	(433)	(16,501)
Other Comprehensive Income (Loss)	(13,982)	(433)	(14,415)
Comprehensive Income (Loss)	4,522	(23,191)	(18,669)

Twenty-Six Weeks Ended July 28, 2012 (in thousands, except per share data)

	As Reported	Effect of Change	As Restated
Cash flow from operating activities:			
Net Income (Loss)	$18,504	$(22,758)	$(4,254)
Deferred Taxes	(20,374)	(14,465)	(34,839)
Inventories	(53,421)	37,656	(15,765)

4. SHARE-BASED COMPENSATION

Financial Statement Impact

The Company recognized share-based compensation expense of $13.6 million and $26.9 million for the thirteen and twenty-six week periods ended August 3, 2013, respectively, and $12.6 million and $25.5 million for the thirteen and twenty-six week periods ended July 28, 2012, respectively. The Company also recognized $5.2 million and $10.2 million in tax benefits related to share-based compensation expense for the thirteen and twenty-six week periods ended August 3, 2013, respectively, and $4.8 million and $9.7 million for the thirteen and twenty-six week periods ended July 28, 2012, respectively.

The fair value of share-based compensation awards is recognized as compensation expense primarily on a straight-line basis over the awards’ requisite service period, net of forfeitures, with the exception of performance share awards. Performance share award expense is primarily recognized in the dependency period of the awards' requisite service period. For awards that are expected to result in a tax deduction, a deferred tax asset is recorded in the period in which share-based compensation expense is recognized. A current tax deduction arises upon the vesting of restricted stock units and performance share awards or the exercise of stock options and stock appreciation rights and is principally measured at the award’s intrinsic value. If the tax deduction is greater than the recorded deferred tax asset, the tax benefit associated with any excess deduction is considered a “windfall tax benefit” and is recognized as additional paid-in capital. If the tax deduction is less than the recorded deferred tax asset, the resulting difference, or shortfall, is first charged to additional paid in capital, to the extent of the pool of “windfall tax benefits,” with any remainder recognized as tax expense. The Company’s pool of “windfall tax benefits” as of August 3, 2013 is sufficient to fully absorb any shortfall which may develop associated with awards currently outstanding.

The Company adjusts share-based compensation expense on a quarterly basis for actual forfeitures and for changes to the estimate of expected award forfeitures. The effect of adjusting the forfeiture rate is recognized in the period the forfeiture estimate is changed. The effect of adjustments for forfeitures during both the twenty-six weeks ended August 3, 2013 and July 28, 2012 was insignificant.

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A&F issues shares of Common Stock from treasury stock upon exercise of stock options and stock appreciation rights and vesting of restricted stock units, including those converted from performance share awards. As of August 3, 2013, A&F had sufficient treasury stock available to settle stock options, stock appreciation rights, restricted stock units and performance share awards outstanding. Settlement of stock awards in Common Stock also requires that the Company has sufficient shares available in stockholder-approved plans at the applicable time.

In the event, at each reporting date during which share-based compensation awards remain outstanding, there are not sufficient shares of Common Stock available to be issued under the Amended and Restated Abercrombie & Fitch Co. 2007 Long-Term Incentive Plan (the “2007 LTIP”) and the Abercrombie & Fitch Co. 2005 Long-Term Incentive Plan (the “2005 LTIP”), or under a successor or replacement plan, the Company may be required to designate some portion of the outstanding awards to be settled in cash, which would result in liability classification of such awards. The fair value of liability-classified awards is re-measured each reporting date until such awards no longer remain outstanding or until sufficient shares of Common Stock become available to be issued under the 2007 LTIP, or under a successor or replacement plan. As long as the awards are required to be classified as a liability, the change in fair value would be recognized in current period expense based on the requisite service period rendered.

Plans

As of August 3, 2013, A&F had two primary share-based compensation plans: the 2005 LTIP, under which A&F grants stock appreciation rights, restricted stock units and performance share awards to associates of the Company and non-associate members of the A&F Board of Directors, and the 2007 LTIP, under which A&F grants stock appreciation rights, restricted stock units and performance share awards to associates of the Company. A&F also has four other share-based compensation plans under which it granted stock options and restricted stock units to associates of the Company and non-associate members of the A&F Board of Directors in prior years.

The 2007 LTIP, a stockholder-approved plan, permits A&F to annually grant awards covering up to 2.0 million of underlying shares of A&F’s Common Stock for each type of award, per eligible participant, plus any unused annual limit from prior years. The 2005 LTIP, a stockholder-approved plan, permits A&F to annually grant awards covering up to 250,000 of underlying shares of A&F’s Common Stock for each award type to any associate of the Company (other than the Chairman and Chief Executive Officer (the "CEO")) who is subject to Section 16 of the Securities Exchange Act of 1934, as amended, at the time of the grant, plus any unused annual limit from prior years. In addition, any non-associate director of A&F is eligible to receive awards under the 2005 LTIP. Under both plans, stock appreciation rights and restricted stock units vest primarily over four years for associates, while performance share awards are primarily earned and vest over three years. Under the 2005 LTIP, restricted stock units typically vest after approximately one year for non-associate directors of A&F. Awards granted to the CEO under the 2007 LTIP have a vesting period defined as the shorter of four years or the period from the award date through the end of the CEO's employment agreement subject to the satisfaction of performance-based criteria for awards granted subsequent to May 7, 2012. Under both plans, stock options have a 10-year term and stock appreciation rights have up to a 10-year term, subject to forfeiture under the terms of the plans. The plans provide for accelerated vesting if there is a change of control as defined in the plans.