Zumiez Inc
Form 10-Q
September 12, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.

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 JULY 29, 2006**
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 000-51300

ZUMIEZ INC.
(Exact name of registrant as specified in its charter)

Washington	**91-1040022**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6300 Merrill Creek Parkway, Suite B, Everett, WA 98203
(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: **(425) 551-1500**

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 o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

Number of shares of Common Stock outstanding as of September 09, 2006 was 27,588,198 shares.

ZUMIEZ INC.

FORM 10-Q
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ZUMIEZ INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)
(Unaudited)

	July 29, 2006 (Unaudited)	January 28, 2006
Assets		
Current assets		
Cash and cash equivalents	$ 4,221	$ 4,737
Marketable Securities	10,366	38,264
Receivables	6,196	3,746
Inventory	51,783	30,559
Prepaid expenses and other	3,610	711
Deferred tax assets	1,485	938
Total current assets	77,661	78,955
Leasehold improvements and equipment, net	45,447	35,456
Goodwill	11,635	
Total long-term assets	57,082	35,456
Total assets	$ 134,743	$ 114,411
Liabilities and Shareholders Equity		
Current liabilities		
Trade accounts payable	$ 30,075	$ 18,623
Accrued payroll and payroll taxes	3,317	4,388
Income taxes payable		3,309
Current portion of deferred rent and tenant allowances	1,180	900
Other accrued liabilities	7,860	4,378
Total current liabilities	42,432	31,598
Long-term deferred rent and tenant allowances, less current portion	10,226	7,595
Deferred tax liabilities	807	1,534
Total long-term liabilities	11,033	9,129
Commitments and contingencies (Note 4)		
Shareholders equity		
Preferred stock, no par value, 40,000,000 shares authorized; none issued and outstanding		
Common stock, no par value, 100,000,000 shares authorized; 27,553,420 shares issued and outstanding at July 29, 2006, 27,259,297 shares issued and outstanding at January 28, 2006	39,885	35,031
Accumulated other comprehensive income (loss)	(16)	(5)
Retained earnings	41,409	38,658
Total shareholders equity	81,278	73,684
Total liabilities and shareholders equity	$ 134,743	$ 114,411

See accompanying notes to condensed consolidated financial statements

ZUMIEZ INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except share and per share amounts)
(Unaudited)

	Three Months Ended July 29, 2006	July 30, 2005	Six Months Ended July 29, 2006	July 30, 2005
Net sales	$ 55,756	$ 39,407	$ 103,541	$ 72,776
Cost of goods sold	36,981	26,633	69,500	50,155
Gross margin	18,775	12,774	34,041	22,621
Selling, general and administrative expenses	16,780	11,502	30,576	21,332
Operating profit	1,995	1,272	3,465	1,289
Interest income, net	231	78	583	34
Other income (expense)	(16)	1	(16)	16
Earnings before income taxes	2,210	1,351	4,032	1,339
Provision for income taxes	568	503	1,281	531
Net income	$ 1,642	$ 848	$ 2,751	$ 808
Basic net income per share	$ 0.06	$ 0.03	$ 0.10	$ 0.03
Diluted net income per share	$ 0.06	$ 0.03	$ 0.10	$ 0.03
Weighted average shares outstanding, Basic	27,396,890	26,573,784	27,299,864	24,592,152
Weighted average shares outstanding , Diluted	28,903,588	28,213,112	28,768,373	26,231,480

See accompanying notes to condensed consolidated financial statements

ZUMIEZ INC.
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY
(in thousands)
(Unaudited)

	Common Stock Shares	Amount	Accumulated Other Comprehensive Loss	Retained Earnings	Total
Balance at January 28, 2006	27,259	$ 35,031	$ (5)	$ 38,658	$ 73,684
Common shares issued including tax benefit of $2,130	294	3,976			3,976
Stock-based compensation expense		878			878
Unrealized gains and losses, net			(11)		(11)
Net income				2,751	2,751
Balance at July 29, 2006	27,553	$ 39,885	$ (16)	$ 41,409	$ 81,278

See accompanying notes to condensed consolidated financial statements

ZUMIEZ INC.
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)
(Unaudited)

	For the Six Months Ended July 29, 2006	July 30, 2005
Cash flows from operating activities		
Net income	$ 2,751	$ 808
Adjustments to reconcile net income to net cash used in operating activities		
Depreciation	4,675	3,466
Deferred tax expense	(1,273)	(528)
Stock compensation expense	878	82
Loss on disposal of assets	5	19
Loss on sale of marketable securities	17	
Excess tax benefit from stock options	(3,102)	
Changes in operating assets and liabilities		
Receivables	(2,282)	(2,952)
Inventory	(16,433)	(13,581)
Prepaid expenses	(2,730)	(1,654)
Trade accounts payable	9,149	8,513
Accrued payroll and payroll taxes	(1,137)	(80)
Income taxes payable	(207)	(2,611)
Other accrued liabilities	2,800	(575)
Deferred rent	(165)	306
Net cash used in operating activities	(7,054)	(8,787)
Cash flows from investing activities		
Additions to leasehold improvements and equipment	(9,260)	(6,382)
Acquisitions, net of cash acquired	(15,273)	
Purchases of marketable securities	(60,412)	
Sales and maturities of marketable securities	88,239	
Net cash provided by (used in) investing activities	3,294	(6,382)
Cash flows from financing activities		
Change in book overdraft		(429)
Borrowings on revolving credit facility		16,450
Payments on revolving credit facility	(732)	(16,450)
Proceeds from exercise	874	458
Proceeds from sale of stock		31,958
Excess tax benefit from stock options	3,102	
Net cash provided by financing activities	3,244	31,987
Net increase (decrease) in cash and cash equivalents	(516)	16,818
Cash and cash equivalents, Beginning of period	4,737	1,026
Cash and cash equivalents, End of period	$ 4,221	$ 17,844
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$	$ 59
Cash paid during the period for income taxes	3,577	2,605

See accompanying notes to condensed consolidated financial statements

ZUMIEZ INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Nature of Business and Basis of Presentation

Basis of Presentation The accompanying unaudited condensed consolidated financial statements 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.

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the consolidated balance sheet as of July 29, 2006, the consolidated statement of operations for the three and six months ended July 29, 2006 and July 30, 2005, the consolidated statement of shareholders equity for the six months ended July 29, 2006, and the consolidated statement of cash flows for the six months ended July 29, 2006 and July 30, 2005.

The financial data at January 28, 2006 is derived from audited financial statements which are included in the Company s Annual Report on Form 10-K for the year ended January 28, 2006, and should be read in conjunction with the audited financial statements and notes thereto. Interim results are not necessarily indicative of results for the full year.

Principles of Consolidation The condensed consolidated financial statements include the accounts of Zumiez Inc. and its subsidiary, Zumiez Nevada, LLC, (collectively, the Company). All significant intercompany transactions and balances are eliminated in consolidation.

Reclassifications Certain amounts in the prior periods have been reclassified to conform to the current period presentation. These reclassifications had no impact on revenue, net income (loss), assets or liabilities in either period presented.

Use of 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 the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. These estimates can also affect supplemental information disclosed by the Company, including information about contingencies, risk, and financial condition. In preparing the financial statements, the Company makes routine estimates and judgments in determining the net realizable value of accounts receivable, inventory, fixed assets, and prepaid allowances. Some of the more significant estimates include the allowance for sales returns, the reserve for inventory valuation estimates and the expected useful lives of fixed assets. Actual results could differ from those estimates. The results of operations for the three and six months ended July 29, 2006 are not necessarily indicative of the results that might be expected for fiscal 2006. For further information, refer to the Company s financial statements and notes included in the Company s Form 10-K filed on March 23, 2006.

Nature of Business The Company is a leading specialty retailer of action sports related apparel, footwear, equipment and accessories operating under the Zumiez brand name. As of July 29, 2006 the Company operated 221 stores primarily located in shopping malls, giving the Company a presence in 23 states. The Company s stores cater to young men and women between the ages of 12 and 24 who seek brands representing a lifestyle centered on activities that include skateboarding, surfing, snowboarding, bicycle motocross (or BMX) and motocross. The Company supports the action sports lifestyle and promotes its brand through a multi-faceted marketing approach that is designed to integrate its brand image with its customers interests. In addition, the Company operates a website which sells merchandise online and provides content and a community for its target customers. The Company, based in Everett, WA, was formed in August 1978 and operates within one reportable segment.

Fiscal Year The Company uses a fiscal calendar widely used by the retail industry which results in a fiscal year consisting of a 52- or 53- week period ending on the Saturday closest to January 31. Each fiscal year consists of four 13-week quarters, with an extra week added to the fourth quarter every five or six years. Fiscal 2005 was the 52-

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week period ended January 28, 2006. The first six months of fiscal 2006 was the 26-week period ended July 29, 2006. The first six months of fiscal 2005 was the 26-week period ended July 30, 2005. Fiscal 2006 is the 53-week period ending February 3, 2007.

Stock Split On April 14, 2005, the Company s Board of Directors and shareholders approved an amendment to the Company s Certificate of Incorporation to effect a 1 for 258.6485 split of the Company s common stock (the Stock Split). The Stock Split became effective on April 20, 2005. All reference to shares in the financial statements and the accompanying notes, including but not limited to the number of shares and per share amounts, unless otherwise noted, have been adjusted to reflect the Stock Split on a retroactive basis. Previously awarded stock options in the Company s common stock have been retroactively adjusted to reflect the Stock Split.

On March 15, 2006, the Company s Board of Directors approved a two for one stock split of the Company s common stock that was effected by a share dividend and became effective April 19, 2006. All reference to shares in the financial statements and the accompanying notes, including but not limited to the number of shares and per share amounts, unless otherwise noted, have been adjusted to reflect the stock split on a retroactive basis. Previously awarded stock options in the Company s common stock have been retroactively adjusted to reflect the stock split.

Reincorporation On April 29, 2005, the Company reincorporated in the State of Washington from the State of Delaware. In connection with the reincorporation, the Company filed new articles of incorporation and adopted new bylaws. The new articles of incorporation changed the Company s common stock from $0.01 par value per share to no par value per share and increased the Company s authorized capital stock.

Initial Public Offering In May 2005, the Company completed an initial public offering of its common stock in which the Company sold 3,750,000 shares and the Company s selling shareholders sold 3,437,500 shares. Net proceeds from the offering received by the Company totaled approximately $29.7 million, after payment of underwriters commissions and offering expenses. The Company did not receive any of the proceeds from the sale of shares of its common stock by the selling shareholders. Prior to this initial public offering, the Company was a majority owned subsidiary of Zumiez Holdings LLC (the Parent), a holding company with no operating activities. The financial position and operating results of the Parent are not included in the Company s financial statements included in this quarterly report. The Parent was dissolved in connection with the Company s initial public offering.

Secondary Offerings In November 2005, a secondary offering of shares of the Company s common stock by certain of its shareholders was completed. The offering consisted of 5,462,500 shares of common stock, including 712,500 shares that were subject to the underwriters over-allotment option. All of the shares were sold by shareholders of the Company and, as a result, the Company did not receive any of the proceeds from the offering.

In June 2006, a secondary offering of shares of the Company s common stock by certain of its shareholders was completed. The offering consisted of 1,609,090 shares of common stock. All of the shares were sold by shareholders of the Company and, as a result, the Company did not receive any of the proceeds from the offering.

2. Summary of Significant Accounting Policies

Information regarding the Company s significant accounting policies is contained in Note 2, Summary of Significant Accounting Policies, to the financial statements in the Company s Form 10-K filed on March 23, 2006. Presented below in this and the following notes is supplemental information that should be read in conjunction with Notes to Financial Statements in that annual report.

Marketable Securities At July 29, 2006, marketable securities, classified as available for sale, were $10.4 million and consisted of municipal and U.S. agency debt instruments with original maturities over 90 days. The portfolio is carried at market value with net unrealized gains and losses recorded as other comprehensive income (loss).

Stock Compensation Effective January 29, 2006 the Company adopted the fair value method of accounting for stock-based compensation arrangements in accordance with Financial Accounting Standards Board (FASB) Statement No. 123(R), Share-Based Payment (SFAS No. 123(R)), using the modified prospective method of transition. Under the provisions of SFAS No. 123(R), the estimated fair value of share based awards granted under the 2005 Stock Incentive Plan is recognized as compensation expense over the vesting period. Using the modified prospective method, compensation expense is recognized beginning with the effective date of adoption of SFAS No. 123(R) for all share based payments (i) granted after the effective date of adoption and (ii) granted prior to the effective date of adoption and after the Company s initial public offering on May 5, 2005.

Prior to January 29, 2006, the Company accounted for stock-based employee compensation plans using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and its related interpretations. Under the provisions of APB 25, no compensation expense was recognized when stock options were granted with exercise prices equal to or greater than market value on the date of grant. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, Accounting for Stock Based Compensation.

The fair values of the options granted after the effective date were estimated using the Black-Scholes valuation model with the assumptions from the table below:

	Three Months Ended July 29, 2006		**Six Months Ended July 29, 2006**	
Dividend yield		%		%
Volatility rate	35.00	%	35.00	%
Forfeiture rate	7.00	%	7.90	%
Average expected life (in years):				
Expected lives Eight years	6.38		6.38	
Expected lives Five years	6.00		6.00	
Expected lives Three years	6.00		6.00	
Average risk-free interest rate:	5.03	%	4.77	%

The following table summarizes the Company s stock option activity for the six months ended July 29, 2006 (in thousands except weighted-average exercise price):

	Number of Options		**Weighted-Average Exercise Price**	
Options outstanding at January 28, 2006	2,812		1.95	
Options granted Year to Date	512		27.92	
Options exercised Year to Date	(284	)	(1.98	)
Options forfeited Year to Date	(33	)	(20.00	)
Options outstanding at July 29, 2006	3,007		6.18	
Options exercisable at July 29, 2006	1,331		1.30	

The Company recorded $540,859 and $877,992 of total stock-based compensation expense for the three and six month periods ended July 29, 2006, respectively of which $0 and $68,852 was attributable to the Board of Directors as required by the provisions of SFAS No. 123(R). The stock-based compensation expense is calculated on an accelerated method over the vesting periods of the related options. This charge had no impact on the Company s reported cash flows. For the three and six-month periods ended July 30, 2005, the Company recorded $41,110 and $82,220, respectively in stock compensation expense pursuant to APB 25. Under the modified prospective method of transition under SFAS No. 123(R), the Company is not required to restate its prior period financial statements to reflect expensing of share-based compensation under SFAS No. 123(R). Therefore, the results as of July 29, 2006 are not directly comparable to the same period in the prior year.

At July 29, 2006, there was approximately $5,457,000 of total unrecognized compensation cost related to unvested stock options of which $607,153 was attributable to the Board of Directors. This cost is expected to be recognized over a weighted-average period of approximately eight years.

The Company accounts for unvested stock-based employee compensation arrangements granted prior to the initial public offering on the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees and related amendments and interpretations. For these awards, the Company complies with the disclosure provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123), Accounting for Stock-Based Compensation.

If the computed fair values of the awards had been amortized to expense over the vesting period of the awards, pro forma net income (loss) and net income (loss) per share would have been reduced to the pro forma amounts indicated in the following table (in thousands, except per share data):

	For the Three Months Ended		**For the Six Months Ended**	
	July 29, 2006	**July 30, 2005**	**July 29, 2006**	**July 30, 2005**
Net income, as reported	$ 1,642	$ 848	$ 2,751	$ 808
Add: Stock-based compensation expense, as reported, net of tax	369	26	599	49
Deduct: Stock-based employee compensation expense determined under fair-value-based method, net of tax	(403)	(92)	(668)	(178)
Pro forma net income	1,607	782	2,682	679
Net income per share:				
Basic as reported	$ 0.06	$ 0.03	$ 0.10	$ 0.03
Basic pro forma	$ 0.06	$ 0.03	$ 0.10	$ 0.03
Diluted as reported	$ 0.06	$ 0.03	$ 0.10	$ 0.03
Diluted pro forma	$ 0.06	$ 0.03	$ 0.09	$ 0.03

Recent accounting pronouncements In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs an Amendment of ARB No. 43, Chapter 4. This statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and spoilage, requiring these items be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005 and became effective for the Company beginning in fiscal 2006. The effect of adopting this statement is not expected to be significant to the Company s financial position and results of operations.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, Accounting Changes and Error Corrections. This Statement requires retrospective application to prior periods financial statements of changes in accounting principle. The provisions of this statement became effective for fiscal periods beginning after December 15, 2005. The standard dictates that changes in accounting principle that are a result of a new pronouncement shall be subject to the reporting provisions of that pronouncement if they exist.

In June 2005 EITF 05-6, Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination , was ratified by the FASB. The EITF reached a consensus on two issues, that leasehold improvements acquired in a business combination should be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date of acquisition, and that leasehold improvements that are placed in service significantly after and not contemplated at or near the beginning of the lease term should be amortized over the shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. The consensus should be applied to leasehold improvements that are purchased or acquired in reporting periods beginning after the FASB ratification on June 29, 2005. On September 28, 2005 the FASB ratified a modification to clarify that the application does not apply to preexisting leasehold improvements. The Company amortizes leasehold improvements pr the guidance set forth in this consensus.

In June 2006, the FASB issued Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN No. 48 to have a material effect on the Company s consolidated financial position or results of operations.

3. Related Party Transactions During the six months ended July 30, 2005, the Company paid $1,000 in fees on behalf of its Parent, which subsequently was dissolved with the initial public offering. During the six months ended July 30, 2005, with the additional payments by the Company on behalf of the Parent, the balance of $149,000 was deemed uncollectible and forgiven by the Company. This amount was reported in shareholders equity and expensed to selling, general and administrative expense.

During the six months ended July 30, 2005, the Company paid Brentwood Private Equity III, LLC a consulting fee of $50,000 under a Corporate Development and Administrative Services Agreement. This agreement was subsequently terminated in connection with the initial public offering

4. Commitments and Contingencies

Litigation The Company is involved from time to time in litigation incidental to its business and the Company may make provisions for potential litigation losses relating thereto. The Company follows SFAS 5, Accounting for Contingencies when assessing pending or potential litigation. Management believes, after considering a number of factors and the nature of the contingencies to which the Company is subject, that the outcome of these contingencies will not have a material adverse effect upon the results of operations or financial condition of the Company.

Insurance Reserves The Company is responsible for medical insurance claims up to a specified aggregate amount. The Company maintains a reserve for estimated medical insurance claims based on historical claims experience and other estimated assumptions. The Company follows SFAS 5, Accounting for Contingencies when assessing pending or potential claims.

5. Net Income Per Share, Basic and Diluted

The Company calculates net income per share in accordance with SFAS No. 128, *Earnings Per Share*, as amended by SFAS No. 123(R). Basic net income per share is based on the weighted average number of common shares outstanding during the period. Diluted net income per share is based on the weighted average number of common shares and common share equivalents outstanding during the period. Common share equivalents included in the computation represent shares issuable upon assumed exercise of outstanding stock options. Potentially dilutive securities not included in the calculation of diluted earnings per share include options to purchase common stock. Total common stock options not included in the calculation of diluted earnings per share were 50,000 and 0 for the three and six months ended July 29, 2006 and July 30, 2005, respectively.

The following table sets forth the computation of basic and diluted net income (loss) per share (in thousands, except share and per share data):

	Three Months Ended July 29, 2006	July 30, 2005
Net income	$ 1,642	$ 848
Weighted average common shares for basic net income per share	27,396,890	26,573,784
Dilutive effect of stock options	1,506,698	1,639.328
Weighted average common shares for diluted net income per share	28,903,588	28,213,112
Basic net income per share	$ 0.06	$ 0.03
Diluted net income per share	$ 0.06	$ 0.03

	Six Months Ended July 29, 2006	July 30, 2005
Net income	$ 2,751	$ 808
Weighted average common shares for basic net income per share	27,299,864	24,592,152
Dilutive effect of stock options	1,468,509	1,639,328
Weighted average common shares for diluted net income per share	28,768,373	26,231,480
Basic net income per share	$ 0.10	$ 0.03
Diluted net income per share	$ 0.10	$ 0.03

6. Intangible Assets and Goodwill

In connection with the acquisition of Fast Forward on June 24, 2006, the Company recorded goodwill in accordance with SFAS No. 141 Business Combintions. The Company recorded $11.6 million of goodwill as the excess of the purchase price of $14.0 million over the fair value of the net amounts assigned to assets acquired and liabilities assumed. In accordance with SFAS 142, Accounting for Goodwill and Other Tangible Assets , the Company will continue to assess, on an annual basis, whether goodwill is impaired.

7. Business Acquisitions

During the quarter ended July 29, 2006, Zumiez completed the acquisition of 100% of the ownership of Action Concepts Fast Forward, Ltd. (a limited partnership) (Fast Forward), an apparel and accessory retail sales company which operated 20 stores, one a temporary location, (17 in Texas, 2 in Oklahoma and 1 in California). The ability to expand operations into Texas with a full complement of stores at one time was the primary reason for the acquisition. Total costs of the acquisition were $14.0 million and were paid in cash plus assumption of liabilities. The Company is in the process of completing an independent appraisal to determine the final allocation of the purchase price. The following table summarizes the preliminary allocation of fair values of the assets acquired and liabilities assumed (in thousands)

Cash in Stores	$ 15
Prepaid Expense	143
Other Current Assets	168
Merchandise Inventory	4,227
Property & Equipment	1,819
Goodwill	11,635
Checks drawn in excess of bank balance	(608)
Accounts Payable	(1,712)
Short term debt	(732)
Other current liabilities	(957)
Fair value of net assets acquired including Goodwill	$ 13,998

The transaction was accounted for under the purchase method of accounting and, accordingly, the purchased assets and assumed liabilities were recorded at their estimated fair values at the date of acquisition. The preliminary purchase price allocation resulted in an excess of purchase price over net tangible assets acquired of $11.6 million. All of the excess of purchase price over net tangible assets acquired was attributed to goodwill, which is not subject to amortization for book purposes. Zumiez will amortize the goodwill for tax purposes utilizing the 338(h)(10)election. The operational results of Fast Forward were included in the consolidated financial statements of Zumiez beginning with the date of the acquisition, June 24, 2006. At July 1, 2006, $360,000 in cash was held in escrow and due for payment to either Zumiez or Fast Forward dependent on future claims. The cash has not been reflected in the purchase price of the related acquisition, but will be reflected in the allocable cost of the acquisition at the time of determination of the contingencies and ultimate distribution to the sellers in accordance with Paragraph 46 of SFAS 141, Business Combinations.

The statement of operations for the period ended July 29, 2006, includes the operating results of Fast Forward from June 24, 2006. The following summarized unaudited pro forma (in thousands) information of Zumiez assumes the acquisition of Fast Forward had occurred as of January 30, 2006. The pro forma information does not purport to indicate what would have occurred had the acquisition been made at January 30, 2006, nor of the results which may occur in the future.

	For the Six month Period Ended	
	July 29, 2006	**July 30, 2005**
Pro Forma Information (Unaudited)		
Net Sales	$ 112,126	$ 87,113
Net Income	1,978	1,009
Basic Earnings Per Share	$ 0.07	$ 0.04
Diluted Earnings Per Share	$ 0.07	$ 0.04

The Company incurred transaction expenses of approximately $640,000 related to the employee severance and transition expense of the acquisition. To date $540,000 has been paid. In addition, the company has a reserve of $225,000 as of July 29, 2006 for the potential clearance of discontinued merchandise from Fast Forward locations and raw materials that may not be consumed. These costs were accounted for under Emerging Issues Task Force (EITF) 95-3 Recognition of Liabilities in Connection with a Purchase Business Combination.

8. Subsequent Event

On September 1, 2006, Zumiez Inc. entered into a secured credit agreement with Wells Fargo HSBC Trade Bank, N.A. The Credit Agreement provides the Company with a senior revolving credit facility (the new facility) through August 30, 2009 of up to $25.0 million. The New Facility replaces the Company s $20.0 million secured revolving credit facility (the prior facility) with Bank of America, N.A., which terminated effective August 31, 2006. The New Facility also contains financial covenants that require the Company to meet certain specified financial ratios, including, minimum net income after taxes, maximum leverage, and quick ratio.

Item 2: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this quarterly report. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed in the section entitled Risk Factors in our Form 10-K filed with the SEC on March 23, 2006 and in this Form 10-Q.

Forward-looking statements are based on our expectations regarding net sales, selling, general and administrative expenses, profitability, financial position, business strategy, new store openings, and plans and objectives of management. The words believe, may, will, estimate, continue, anticipate, intend, expect and similar expressions, as they relate to us and our business, industry, markets and consumers, are intended to identify forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including, among others, those described in Risk Factors and elsewhere in this quarterly report and in the Form 10-K referred to in the preceding paragraph. New risk factors emerge from time to time and it is not possible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. We assume no obligation to update any *forward-looking statements as a result of new information, future events or developments. References in the following discussion to we , us , our , the Company and similar references mean Zumiez Inc. and its consolidated subsidiary, unless otherwise expressly stated or the context otherwise requires.*

Overview

We are a leading specialty retailer of action sports related apparel, footwear, equipment and accessories operating under the Zumiez brand name. Our stores cater to young men and women between the ages of 12 and 24 who seek popular brands representing a lifestyle centered on activities that include skateboarding, surfing, snowboarding, BMX, and motocross. We support the action sports lifestyle and promote our brand through a multi-faceted marketing approach that is designed to integrate our brand image with our customers activities and interests.

In May 2005, we completed an initial public offering of our common stock in which we sold 3,750,000 shares and our selling shareholders sold 3,437,500 shares. Net proceeds received by us from the offering totaled approximately $29.7 million, after payment of underwriters commissions and offering expenses. We intend to use the remaining net proceeds from the offering, together with cash flow from operations, to fund new store openings, store improvements, infrastructure improvements, working capital and other general corporate purposes. We did not receive any of the proceeds from the sale of shares of our common stock by the selling shareholders.

In November 2005, a secondary offering of shares of our common stock by certain of our shareholders was completed. The offering consisted of 5,462,500 shares of common stock, including 712,500 shares that were subject to the underwriters over-allotment option. All of the shares were sold by our shareholders and, as a result, we did not receive any of the proceeds from the offering.

In June 2006, a secondary offering of shares of the Company s common stock by certain of its shareholders was completed. The offering consisted of 1,609,090 shares of common stock. All of the shares were sold by shareholders of the Company and, as a result, the Company did not receive any of the proceeds from the offering.

During the quarter ended July 29, 2006, Zumiez completed the acquisition of 100% of the ownership of Action Concepts Fast Forward, Ltd. (a limited partnership) (Fast Forward), an apparel and accessory retail sales company which operated 20 stores (17 in Texas, 2 in Oklahoma and 1 in California). The ability to expand operations into Texas with a full complement of stores at one time was the primary reason for the acquisition.

General

Net sales constitute gross sales net of returns. Net sales include our in-store sales and our Internet sales and, accordingly, information in this quarterly report with respect to comparable store sales, net sales per store and net sales per square foot includes our Internet sales. Our internet sales are and have historically been less than 1% of total sales. Sales with respect to gift cards are deferred and recognized when gift cards are redeemed.

We report comparable store sales based on net sales, and stores are included in our comparable store sales beginning on the first anniversary of their first day of operation. Changes in our comparable store sales between two periods are based on net sales of stores which were in operation during both of the two periods being compared and, if a store is included in the calculation of comparable store sales for only a portion of one of the two periods being compared, then that store is included in the calculation for only the comparable portion of the other period. When additional square footage is added to a store that is included in comparable store sales, the store remains in comparable store sales. The recently acquired 20 Fast Forward stores are being treated as new stores and will move into our comparable store base according to our current reporting method, and will be a comparable store on the first anniversary of the acquisition date, June 24, 2007. There may be variations in the way in which some of our competitors and other apparel retailers calculate comparable or same store sales. As a result, data regarding our comparable store sales may not be comparable to similar data made available by our competitors or other retailers.

Cost of goods sold consists of the cost of merchandise sold to customers, inbound shipping costs, distribution costs, depreciation on leasehold improvements at our distribution center, buying and merchandising costs and store occupancy costs. This may not be comparable to the way in which our competitors or other retailers compute their cost of goods sold.

Selling, general and administrative expenses consist primarily of store personnel wages and benefits, administrative staff and infrastructure expenses, store supplies, depreciation on leasehold improvements at our home office and stores, facility expenses, and training, advertising and marketing costs. Credit card fees, insurance and other miscellaneous operating costs are also included in selling, general and administrative expenses. This may not be comparable to the way in which our competitors or other retailers compute their selling, general and administrative expenses. Our selling, general and administrative expenses have increased, as described below, and will further increase in future periods due in part to increased expenses associated with operating as a public company, including compliance with the Sarbanes-Oxley Act of 2002.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in conformity with generally accepted accounting principles in the United States (GAAP). In preparing financial statements in accordance with GAAP, we are required to make estimates and assumptions that have an impact on the assets, liabilities, revenue and expense amounts reported. These estimates can also affect supplemental information disclosed by us, including information about contingencies, risk, and financial condition. We believe, given current facts and circumstances, that our estimates and assumptions are reasonable, adhere to GAAP, and are consistently applied. Inherent in the nature of an estimate or assumption is the fact that actual results may differ from estimates and estimates may vary as new facts and circumstances arise. In preparing the financial statements, we make routine estimates and judgments in determining the net realizable value of accounts receivable, inventory, fixed assets, and prepaid allowances. We believe our most critical accounting estimates and assumptions are in the following areas:

Valuation of merchandise inventories. We carry our merchandise inventories at the lower of cost or market. Merchandise inventories may include items that have been written down to our best estimate of their net realizable value. Our decisions to write-down our merchandise inventories are based on our current rate of sale, the age of the inventory and other factors. Actual final sales prices to our customers may be higher or lower than our estimated sales prices and could result in a fluctuation in gross margin. Historically, any additional write-downs have not been significant and we do not adjust the historical carrying value of merchandise inventories upwards based on actual sales experience.

Leasehold improvements and equipment. We review the carrying value of our leasehold improvements and equipment for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Measurement of the impairment loss is based on the fair value of the asset or group of assets. Generally, fair value will be determined using valuation techniques, such as the expected present value of future cash flows. The actual economic lives of these assets may be different than our estimated useful lives, thereby resulting in a different carrying value. These evaluations could result in a change in the depreciable lives of those assets and therefore our depreciation expense in future periods.

Revenue recognition and sales returns reserve. We recognize revenue upon purchase by customers at our retail store locations or upon shipment for orders placed through our website as both title and risk of loss have transferred. We offer a return policy of generally 30 days and we accrue for estimated sales returns based on our historical sales returns results. The amounts of these sales returns reserves vary during the year due to the seasonality of our business. Actual sales returns could be higher or lower than our estimated sales returns due to customer buying patterns that could differ from historical trends.

Impairment of Long-Lived Assets. The Company accounts for long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal 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. Recoverability of assets to be held and used is determined by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered impaired, the impairment recognized is

measured by comparing projected individual store discounted cash flow to the asset carrying values. Declines in projected store cash flow could result in the impairment of assets.

Accounting for Income Taxes. As part of the process of preparing the financial statements, income taxes are estimated for each of the jurisdictions in which the Company operates. This process involves estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the balance sheet. The likelihood that deferred tax assets will be recovered from future taxable income is assessed, recognizing that future taxable income may give rise to new deferred tax assets. To the extent that future recovery is not likely, a valuation allowance would be established. To the extent that a valuation allowance is established or increased, an expense will be included within the tax provision in the income statement.

Significant management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. Based on the Company s history of operating earnings, no valuation allowance has been recorded as of July 29, 2006. In the event that actual results differ from these estimates, or these estimates are adjusted in future periods, a valuation allowance may need to be established, which could impact the Company s financial position and results of operations.

Provisions for income taxes are based on numerous factors that are subject to audit by the Internal Revenue Service and the tax authorities in the various jurisdictions in which the Company does business

Stock-based compensation. Effective January 29, 2006 the Company adopted the fair value method of accounting for stock-based compensation arrangements in accordance with Financial Accounting Standards Board (FASB) Statement No. 123(R), Share-Based Payment (SFAS No. 123(R)), using the modified prospective method of transition. Under the provisions of SFAS No. 123(R), the estimated fair value of share based awards granted under the 2005 Stock Incentive Plan is recognized as compensation expense over the vesting period. Using the modified prospective method, compensation expense is recognized beginning with the effective date of adoption of SFAS No. 123(R) for all share based payments (i) granted after the effective date of adoption and (ii) granted prior to the effective date of adoption and after the Company s initial public offering on May 5, 2005.

Prior to January 29, 2006, the Company accounted for stock-based employee compensation plans using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and its related interpretations. Under the provisions of APB 25, no compensation expense was recognized when stock options were granted with exercise prices equal to or greater than market value on the date of grant. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, Accounting for Stock Based Compensation.

The Company recorded $540,859 and $877,992 of total stock-based compensation expense for the three and six month periods ended July 29, 2006, respectively of which $0 and $68,852 was attributable to the Board of Directors , respectively as required by the provisions of SFAS No. 123(R). The stock-based compensation expense is calculated on an accelerated method over the vesting periods of the related options. This charge had no impact on the Company s reported cash flows. For the three and six month period ended July 30, 2005, the Company recorded $41,110 and $82,220, respectively in stock compensation expense pursuant to APB 25. Under the modified prospective method of transition under SFAS No. 123(R), the Company is not required to restate its prior period financial statements to reflect expensing of share-based compensation under SFAS No. 123(R). Therefore, the results as of July 29, 2006 are not directly comparable to the same period in the prior year.

At July 29, 2006, there was approximately $5.5 million of total unrecognized compensation cost related to unvested stock options of which $607,153 was attributable to the Zumiez Board of Directors. This cost is expected to be recognized over a weighted-average period of approximately eight years.

The Company accounts for unvested stock-based employee compensation arrangements granted prior to the initial public offering on the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees and related amendments and interpretations.

For these awards, the Company complies with the disclosure provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123), Accounting for Stock-Based Compensation.

Results of Operations

The following table presents, for the periods indicated, selected items in the statements of operations as a percent of net sales:

	Three Months Ended				Six Months Ended			
	July 29, 2006		July 30, 2005		July 29, 2006		July 30, 2005	
Net sales	100.0	%	100	%	100.0	%	100.0	%
Cost of goods sold	66.3		67.6		67.1		68.9	
Gross margin	33.7		32.4		32.9		31.1	
Selling, general and administrative expenses	30.1		29.2		29.5		29.3	
Operating profit								
	3.6		3.2		3.4		1.8	
Interest income , net	0.4		0.2		0.6			
Other income								
Earnings before income taxes	4.0		3.4		3.9		1.8	
Provision for income taxes	1.0		1.3		1.2		0.7	
Net income	3.0	%	2.1	%	2.7	%	1.1	%

Three Months (13 weeks) Ended July 29, 2006 Compared With Three Months (13 weeks) Ended July 30, 2005

Net Sales

Net sales increased to $55.8 million for the three months ended July 29, 2006 from $39.4 million for the three months ended July 30, 2005, an increase of $16.4 million, or 41.6%. Comparable store net sales increased by 12.6% for the three months ended July 29, 2006 compared to 11.3% for the three months ended July 30, 2005. The increase in total net sales was due to an increase in comparable store net sales of approximately $5.0 million and an increase in net sales from non-comparable stores of approximately $11.2 million. The increase in non-comparable store net sales was primarily due to the opening of 71 new and Fast Forward acquisition stores subsequent to July 30, 2005. The increase at comparable stores was primarily due to higher net sales of men s apparel and accessories. For information as to how we define comparable stores, see General above.

Gross Margin

Gross margin for the three months ended July 29, 2006 was $18.8 million compared with $12.8 million for the three months ended July 30, 2005, an increase of $6.0 million, or 46.9%. As a percentage of net sales, gross margin increased to 33.7% for the three months ended July 29, 2006 from 32.4% for the three months ended July 30, 2005. The increase in gross margin as a percentage of net sales was due primarily to improved pricing from some of our vendors due to our larger merchandise purchases, a reduced markdown rate from prior year due to less aged inventory and to a lesser extent, our ability to leverage certain fixed costs, such as distribution, and product teams over greater overall net sales.

Selling, General and Administrative Expenses

Selling, general and administrative, or SG&A, expenses in the three months ended July 29, 2006 were $16.8 million compared with $11.5 million in the three months ended July 30, 2005, an increase of $5.3 million, or 46.1%. This increase was primarily the result of costs associated with operating new stores as well as increases in infrastructure and administrative staff to support our growth and increased costs associated with being a public company, including Sarbanes-Oxley compliance. As a percentage of net sales, SG&A expenses increased to 30.1% in the three months ended July 29, 2006 from 29.2% in the three months ended July 30, 2005. The increase in SG&A expenses as a percentage of net sales was primarily attributable to the expensing of stock based compensation of $0.5 million, related to the adoption of FAS 123R this year and an increase in store payroll for new stores of $2.4 million and additional depreciation of $0.6 million

Operating Profit

As a result of the above factors, operating profit increased by $0.7 million to $2.0 million in the three months ended July 29, 2006 compared with an operating profit of $1.3 million in the three months ended July 30, 2005. As a percentage of net sales, operating profit was 3.6% in the three months ended July 29, 2006 compared with 3.2% in the three months ended July 30, 2005.

Provision for Income Taxes

Provision for income taxes was $0.6 million for the three months ended July 29, 2006 compared with $0.5 million for the three months ended July 30, 2005.

Net Income

Net income increased by $0.8 million, or 94.0%, to $1.6 million in the three months ended July 29, 2006 from $0.8 million in the three months ended July 30, 2005. As a percentage of net sales, net income was 2.9% in the three months ended July 29, 2006 compared with 2.1% in the three months ended July 30, 2005.

Six Months (26 weeks) Ended July 29, 2006 Compared With Six Months (26 weeks) Ended July 30, 2005

Net Sales

Net sales increased to $103.5 million for the six months ended July 29, 2006 from $72.8 million for the six months ended July 30, 2005, an increase of $30.7 million, or 42.2%. Comparable store net sales increased by 15.8% for the six months ended July 29, 2006 compared to the six months ended July 30, 2005, and 11.6% for the six months ended July 30, 2005 compared to the six months ended July 31, 2004. The increase in total net sales was due to an increase in comparable store net sales of approximately $11.6 million and an increase in net sales from non-comparable stores of approximately $19.0 million. The increase in non-comparable store net sales was primarily due to the opening of 71 new and Fast Forward acquisition stores subsequent to July 30, 2005. The increase in comparable stores was primarily due to higher net sales of men s apparel and accessories. For information as to how we define comparable stores, see General above.

Gross Margin

Gross margin for the six months ended July 29, 2006 was $34.0 million compared with $22.6 million for the six months ended July 30, 2005, an increase of $11.4 million, or 50.4%. As a percentage of net sales, gross margin increased to 32.9% for the six months ended July 29, 2006 from 31.1% for the six months ended July 30, 2005. The increase in gross margin as a percentage of net sales was due primarily to improved pricing from some of our vendors due to our larger merchandise purchases, our ability to leverage certain fixed costs, primarily non-variable occupancy costs over greater overall net sales, and a reduced markdown rate from prior year due to less aged inventory.

Selling, General and Administrative Expenses

Selling, general and administrative, or SG&A, expenses in the six months ended July 29, 2006 were $30.6 million compared with $21.3 million in the six months ended July 30, 2005, an increase of $9.3 million, or 43.7%. This increase was primarily the result of costs associated with operating new stores as well as increases in infrastructure and administrative staff to support our growth and increased costs associated with being a public company, including Sarbanes-Oxley compliance. As a percentage of net sales, SG&A expenses increased to 29.5% in the six months ended July 29, 2006 from 29.3% in the six months ended July 30, 2005. The increase in SG&A expenses as a percentage of net sales was primarily attributable to the expensing of stock based compensation of $0.9 million, related to the adoption of FAS 123R this year, and an increase in store payroll for new stores of $4.3 million and additional depreciation of $1.1 million.

Operating Profit

As a result of the above factors, operating profit increased to $3.5 million in the six months ended July 29, 2006 compared with $1.3 million in the six months ended July 30, 2005. As a percentage of net sales, operating profit was 3.3% in the six months ended July 29, 2006 compared with 1.8% in the six months ended July 30, 2005.

Provision for Income Taxes

Provision for income taxes was $1.3 million for the six months ended July 29, 2006 compared with $0.5 million for the six months ended July 30, 2005.

Net Income

Net income increased to $2.8 million in the six months ended July 29, 2006 from net income of $0.8 million in the six months ended July 30, 2005, an increase of 240%. As a percentage of net sales, net income was 2.7% in the six months ended July 29, 2006 compared with 1.1% in the six months ended July 30, 2005.

Liquidity and Capital Resources

Our primary capital requirements are for inventory, store fixtures, store construction and remodeling, capital investments and ongoing infrastructure improvements such as technology enhancements and distribution capabilities. Historically, our main sources of liquidity have been cash flows from operations, borrowings under our revolving credit facility and proceeds from the sale of our equity securities.

The Registration Statement (SEC File No. 333-122865) for our initial public offering was declared effective by the Securities and Exchange Commission on May 5, 2005. We and the selling shareholders sold 3,750,000 shares and 3,437,500 shares of common stock, respectively, in the offering at a public offering price of $9.00 per share (on a split-adjusted basis), for aggregate gross proceeds of approximately $33.8 million and $30.9 million, respectively. In connection with this offering we paid underwriters commissions of approximately $2.4 million and incurred offering expenses of approximately $1.7 million. After deducting the underwriters commissions and the offering expenses, we received net proceeds of approximately $29.7 million from the offering. We did not receive any of the proceeds from the sale of the shares offered by the selling shareholders.

The significant components of our working capital are inventory and liquid assets such as cash, marketable securities and receivables, specifically tenant allowances and credit card receivables, reduced by short-term debt, accounts payable and accrued expenses. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day or within several days of the related sale, while we typically have extended payment terms with our vendors.

Our capital requirements include construction and fixture costs related to the opening of new stores and for maintenance and remodeling expenditures for existing stores. Future capital requirements will depend on many factors, including the pace of new store openings, the availability of suitable locations for new stores, and the nature of arrangements negotiated with landlords. In that regard, our net investment to open a new store has varied significantly in the past due to a number of factors, including the geographic location and size of the new store, and is likely to vary significantly in the future. During fiscal 2006, we expect to spend approximately $19.1 million on capital expenditures, a majority of which will relate to leasehold improvements and fixtures for the 42 total new stores we plan to open in fiscal 2006, and a smaller amount will relate to equipment, systems and improvements for our distribution center and support infrastructure. However, there can be no assurance that the number of stores that we actually open in fiscal 2006 will not be different from the number of stores we plan to open, or that actual fiscal 2006 capital expenditures will not differ from this expected amount.

We expect cash flows from operations, available borrowings under our revolving credit facility and the remaining net proceeds from our initial public offering will be sufficient to meet our foreseeable cash requirements for operations and planned capital expenditures for at least the next twelve months. Beyond this time frame, if these sources are not sufficient to meet our capital requirements, then we will be required to obtain additional equity or debt financing in the future. There can be no assurance that equity or debt financing will be available to us when and if we need it or, if available, that the terms will be satisfactory to us and not dilutive to our then-current shareholders.

Net cash used in operating activities in the six months ended July 29, 2006 was $7.1 million primarily related to an increase in inventory levels and tax benefits from stock option exercises. and $8.8 million in the six months ended July 30, 2005 primarily related to an increase in inventory levels and a decrease in operating liabilities.

Net cash provided by investing activities was $3.3 million in the six months ended July 29, 2006, with $15.3 million used for the Fast Forward acquisition and $9.3 million for capital expenditures and the sale of marketable securities to generate the balance, and net cash used in investing activities was $6.4 million in the six months ended July 30, 2005, related to capital expenditures for new store openings and existing store renovations.

Net cash provided by financing activities in the six months ended July 29, 2006 was $3.2 million, related to the tax benefits received from the exercise of stock options, and $32.0 million in the six months ended July 30, 2005 related to our initial public offering.

We have a $20.0 million secured revolving credit facility with a lender. The revolving credit facility provides for the issuance of commercial letters of credit in an amount not to exceed $7.5 million outstanding at any time and with a term not to exceed 180 days, although the amount of borrowings available at any time under our revolving credit facility is reduced by the amount of letters of credit outstanding at that time. There were no outstanding borrowings under the revolving credit facility at July 29, 2006 or January 28, 2006. We had open letters of credit of $2.7 million at July 29, 2006 and $374,000 at January 28, 2006. The revolving credit facility bears interest at floating rates based on the lower of the prime rate (8.25% at July 29, 2006) minus a prime margin ranging from 0.75% to 1.0% or the LIBOR rate (5.40% at July 29, 2006) plus a LIBOR margin ranging from 1.40% to 2.15%, in each case depending on the ratio of the Company s adjusted funded debt (as defined in the loan agreement, as amended) to EBITDAR (as defined in the loan agreement, as amended). The revolving credit facility will expire on July 31, 2006 and is currently a month to month arrangement as we renegotiate terms. We expect the terms of any renegotiated credit facility to be similar to those previously negotiated. The borrowing capacity can be increased to $25.0 million if we request and if we are in compliance with certain provisions. Our obligations under the revolving credit facility are secured by almost all of our personal property, including, among other things, our inventory, equipment and fixtures. We must also provide financial information and statements to our lender and we must reduce the amount of any outstanding advances under the revolving credit facility to no more than $5.0 million for a period of at least 30 consecutive days of each year. Our revolving credit facility also contains financial covenants that require us to meet certain specified financial ratios, including a debt to earnings ratio, earnings to interest expense ratio and an inventory to debt ratio. We were in compliance with all covenants at July 29, 2006.

On September 1, 2006, we entered into a secured credit agreement with Wells Fargo HSBC Trade Bank, N.A. The credit agreement provides us with a senior revolving credit facility (the new facility) through August 30, 2009 of up to $25.0 million. The New Facility replaces our $20.0 million secured revolving credit facility with Bank of America, N.A., which terminated effective August 31, 2006. The New Facility also contains financial covenants that require us to meet certain specified financial ratios, including, minimum net income after taxes, maximum leverage, and quick ratio. The prior facility with the Bank of America was scheduled to expire on July 1, 2006 and had been extended on a month-to-month basis through its expiration on August 31, 2006

Contractual Obligations and Commercial Commitments

There were no material changes outside the ordinary course of business in our contractual obligations during the quarter ended July 29, 2006. Our operating lease obligations are not recognized as liabilities in the financial statements. The following table summarizes the total amount of future payments due under certain of our contractual obligations at July 29, 2006:

	Payments Due In Fiscal Year						
	Total	2006 (last 6 months)	2007	2008	2009	2010	2011 and Beyond
	(Dollars in thousands)						
Contractual obligations:							
Non-cancelable operating lease obligations	$ 125,896	$ 8,834	$ 16,858	$ 16,284	$ 16,247	$ 15,488	$ 52,185
Total contractual cash obligations	$ 125,896	$ 8,834	$ 16,858	$ 16,284	$ 16,247	$ 15,488	$ 52,185

We occupy our retail stores and combined home office and distribution center under operating leases generally with terms of seven to ten years. Some of our leases have early cancellation clauses, which permit the lease to be terminated by us if certain sales levels are not met in specific periods. Some leases contain renewal options for periods ranging from one to five years under substantially the same terms and conditions as the original leases. In addition to future minimum lease payments, substantially all of our store leases provide for additional rental payments (or percentage rent) if sales at the respective stores exceed specified levels, as well as the payment of common area maintenance charges and real estate taxes. Amounts in the above table do not include percentage rent, common area maintenance charges or real estate taxes. Most of our lease agreements have defined escalating rent provisions, which we have straight-lined over the term of the lease, including any lease renewals deemed to be probable. For certain locations, we receive cash tenant allowances and we have reported these amounts as a deferred liability which is amortized to rent expense over the term of the lease, including any lease renewals deemed to be probable. Total rental expenses, including percentage rent, common area maintenance costs and real estate taxes, under operating leases were $13.0 million and $9.6 million for the six months ended July 29, 2006 and the six months ended July 30, 2005, respectively, and $13.9 million, $17.1 million and $22.2 million for fiscal 2003, 2004 and 2005, respectively. We amortize our leasehold improvements over the shorter of the useful life of the asset or the lease term.

Off-Balance Sheet Obligations

Our only off-balance sheet contractual obligations and commercial commitments as of July 29, 2006 related to operating lease obligations and letters of credit. We have excluded these items from our balance sheet in accordance with generally accepted accounting principles. We presently do not have any non-cancelable purchase commitments. At July 29, 2006, we had outstanding purchase orders to acquire merchandise from vendors for approximately $65.0 million. These purchases are expected to be financed by cash flows from operations and borrowings under our revolving credit facility. We have an option to cancel these commitments with no notice prior to shipment. At July 29, 2006, we had $2.7 million of letters of credit outstanding under our revolving credit facility.

Impact of Inflation

We do not believe that inflation has had a material impact on our net sales or operating results in the recent past. There can be no assurance that our business will not be affected by inflation in the future.

Risk Factors

You should carefully consider the risks described below and elsewhere in this quarterly report, which could materially and adversely affect our business, results of operations or financial condition. If any of the following risks actually occurs, the market price of our common stock would likely decline.

Our growth strategy depends on our ability to open and operate a significant number of new stores each year, which could strain our resources and cause the performance of our existing stores to suffer.

Our growth largely depends on our ability to open and operate new stores successfully. However, our ability to open new stores is subject to a variety of risks and uncertainties, and we may be unable to open new stores as planned, and any failure to successfully open and operate new stores would have a material adverse effect on our results of operations and on the market price of our common stock. We intend to continue to open a significant number of new stores in future years while remodeling a portion of our existing store base annually. In addition, our proposed expansion will place increased demands on our operational, managerial and administrative resources. These increased demands could cause us to operate our business less effectively, which in turn could cause deterioration in the financial performance of our individual stores and our overall business. To the extent our new store openings are in markets where we already have stores, we may experience reduced net sales in existing stores in those markets. In addition, successful execution of our growth strategy may require that we obtain additional financing, and we cannot assure you that we will be able to obtain that financing on acceptable terms or at all.

If we fail to effectively execute our expansion strategy, we may not be able to successfully open new store locations in a timely manner, if at all, which could have an adverse affect on our net sales and results of operations.

Our ability to open and operate new stores successfully depends on many factors, including, among others, our ability to:

- identify suitable store locations, the availability of which is outside of our control;
- negotiate acceptable lease terms, including desired tenant improvement allowances;
- source sufficient levels of inventory at acceptable costs to meet the needs of new stores;
- hire, train and retain store personnel;
- successfully integrate new stores into our existing operations; and
- identify and satisfy the merchandise preferences of new geographic areas.

In addition, many of our planned new stores are to be opened in regions of the United States in which we currently have few, or no, stores. The expansion into these markets may present competitive, merchandising and distribution challenges that are different from those currently encountered in our existing markets. Any of these challenges could adversely affect our business and results of operations.

Our business is dependent upon our being able to anticipate, identify and respond to changing fashion trends, customer preferences and other fashion-related factors; failure to do so could have a material adverse effect on us.

Customer tastes and fashion trends in the action sports lifestyle market are volatile and tend to change rapidly. Our success depends on our ability to effectively anticipate, identify and respond to changing fashion tastes and consumer preferences, and to translate market trends into appropriate, saleable product offerings in a timely manner. If we are unable to successfully anticipate, identify or respond to changing styles or trends and misjudge the market for our products or any new product lines, our sales may be lower than predicted and we may be faced with a substantial amount of unsold inventory or missed opportunities. In response to such a situation, we may be forced to rely on markdowns or promotional sales to dispose of excess or slow-moving inventory, which could have a material adverse effect on our results of operations.

Our ability to attract customers to our stores depends heavily on the success of the shopping malls in which our stores are located; any decrease in customer traffic in those malls could cause our sales to be less than expected.

In order to generate customer traffic we depend heavily on locating our stores in prominent locations within successful shopping malls. Sales at these stores are derived, in part, from the volume of traffic in those malls. Our stores benefit from the ability of a mall s other tenants to generate consumer traffic in the vicinity of our stores and

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the continuing popularity of malls as shopping destinations. Our sales volume and mall traffic generally may be adversely affected by, among other things, economic downturns in a particular area, competition from Internet retailers, non-mall retailers and other malls, increases in gasoline prices and the closing or decline in popularity of other stores in the malls in which we are located. A reduction in mall traffic as a result of these or any other factors could have a material adverse effect on our business, results of operations and financial condition.

Our sales and inventory levels fluctuate on a seasonal basis, leaving our operating results particularly susceptible to changes in back-to-school and holiday shopping patterns.

Our sales are typically disproportionately higher in the third and fourth fiscal quarters of each fiscal year due to increased sales during the back-to-school and winter holiday shopping seasons. Sales during these periods cannot be used as an accurate indicator of annual results. Our sales in the first and second fiscal quarters are typically lower than in our second and third fiscal quarters due, in part, to the traditional retail slowdown immediately following the winter holiday season. Any significant decrease in sales during the back-to-school and winter holiday seasons would have a material adverse effect on our financial condition and results of operations.

In addition, in order to prepare for the back-to-school and winter holiday shopping seasons, we must order and keep in stock significantly more merchandise than we carry during other parts of the year. Any unanticipated decrease in demand for our products during these peak shopping seasons could require us to sell excess inventory at a substantial markdown, which could have a material adverse effect on our business, results of operations and financial condition.

Our quarterly results of operations are volatile and may decline.

Our quarterly results of operations have fluctuated significantly in the past and can be expected to continue to fluctuate significantly in the future. As discussed above, our sales and operating results are typically lower in the first and second quarters of our fiscal year due, in part, to the traditional retail slowdown immediately following the winter holiday season. Our quarterly results of operations are affected by a variety of other factors, including:

- the timing of new store openings and the relative proportion of our new stores to mature stores;
- fashion trends and changes in consumer preferences;
- calendar shifts of holiday or seasonal periods;
- changes in our merchandise mix;
- timing of promotional events;
- general economic conditions and, in particular, the retail sales environment;
- actions by competitors or mall anchor tenants;
- weather conditions;
- the level of pre-opening expenses associated with our new stores; and
- inventory shrinkage beyond our historical average rates.

Our business is susceptible to weather conditions that are out of our control, and unseasonable weather could have a negative impact on our results of operations.

Our business is susceptible to unseasonable weather conditions. For example, extended periods of unseasonably warm temperatures during the winter season or cool weather during the summer season could render a portion of our

inventory incompatible with those unseasonable conditions. These prolonged unseasonable weather conditions, particularly in the western United States where we have a concentration of stores, could have a material adverse effect on our business and results of operations.

We may be unable to compete favorably in the highly competitive retail industry, and if we lose customers to our competitors, our sales could decrease.

The teenage and young adult retail apparel, hardgoods and accessories industry is highly competitive. We compete with other retailers for vendors, teenage and young adult customers, suitable store locations, qualified store associates and management personnel. In the softgoods markets, which includes apparel, accessories and footwear, we currently compete with other teenage-focused retailers such as Abercrombie & Fitch Co., Aeropostale, Inc., American Eagle Outfitters, Inc., Anchor Blue Clothing Company, Charlotte Russe Inc., Claire s Stores, Inc., Forever 21, Inc., Hollister Co., Hot Topic, Inc., Old Navy, Inc., Pacific Sunwear of California, Inc., The Buckle, Inc., The Wet Seal, Inc. and Urban Outfitters, Inc. In addition, in the softgoods market we compete with independent specialty shops, department stores, and direct marketers that sell similar lines of merchandise and target customers through catalogs and e-commerce. In the hardgoods markets, which includes skateboards, snowboards, bindings, components and other equipment, we compete directly or indirectly with the following categories of companies: other specialty retailers that compete with us across a significant portion of our merchandising categories, such as local snowboard and skate shops; large-format sporting goods stores and chains, such as Big 5 Sporting Goods Corporation, Dick s Sporting Goods, Inc., Sport Chalet, Inc. and The Sports Authority Inc., which operates stores under the brand names Sports Authority, Gart Sports, Oshman s and Sportmart; and Internet retailers.

Some of our competitors are larger than we are and have substantially greater financial, marketing and other resources than we do. Direct competition with these and other retailers may increase significantly in the future, which could require us, among other things, to lower our prices and could result in the loss of our customers. Current and increased competition could have a material adverse effect on our business, results of operations and financial condition.

If we fail to maintain good relationships with vendors or if a vendor is otherwise unable or unwilling to supply us with adequate quantities of their products at acceptable prices, our business and financial performance could suffer.

Our business is dependent on continued good relations with our vendors. In particular, we believe that we generally are able to obtain attractive pricing and other terms from vendors because we are perceived as a desirable customer, and deterioration in our relationship with our vendors would likely have a material adverse effect on our business. We do not have any contractual relationships with our vendors and, accordingly, there can be no assurance that our vendors will provide us with an adequate supply or quality of products or acceptable pricing. Our vendors could discontinue selling to us or raise the prices they charge at any time. There can be no assurance that we will be able to acquire desired merchandise in sufficient quantities on terms acceptable to us in the future. Also, certain of our vendors sell their products directly to the retail market and therefore compete with us directly, and other vendors may decide to do so in the future. There can be no assurance that such vendors will not decide to discontinue supplying their products to us, supply us only less popular or lesser quality items, raise the prices they charge us or focus on selling their products directly. Any inability to acquire suitable merchandise at acceptable prices, or the loss of one or more key vendors, would have a material adverse effect on our business, results of operations and financial condition.

If we lose key management or are unable to attract and retain the talent required for our business, our financial performance could suffer.

Our performance depends largely on the efforts and abilities of our senior management, including our Co-Founder and Chairman, Thomas D. Campion, our President and Chief Executive Officer, Richard M. Brooks, our Chief Financial Officer, Brenda I. Morris, and our General Merchandising Manager, Lynn K. Kilbourne. None of our employees, except Mr. Brooks, has an employment agreement with us and we do not plan to obtain key person life insurance covering any of our employees. If we lose the services of one or more of our key executives, we may not be able to successfully manage our business or achieve our growth objectives. As our business grows, we will need to attract and retain additional qualified management personnel in a timely manner and we may not be able to do so.

Our failure to meet our staffing needs could adversely affect our ability to implement our growth strategy and could have a material impact on our results of operations.

Our success depends in part upon our ability to attract, motivate and retain a sufficient number of qualified employees, including regional managers, district managers, store managers and store associates, who understand and appreciate our corporate culture based on a passion for the action sports lifestyle and are able to adequately represent this culture to our customers. Qualified individuals of the requisite caliber, skills and number needed to fill these positions may be in short supply in some areas, and the employee turnover rate in the retail industry is high. Competition for qualified employees could require us to pay higher wages to attract a sufficient number of suitable employees. If we are unable to hire and retain store managers and store associates capable of consistently providing a high level of customer service, as demonstrated by their enthusiasm for our culture and knowledge of our merchandise, our ability to open new stores may be impaired and the performance of our existing and new stores could be materially adversely affected. We are also dependent upon temporary personnel to adequately staff our stores and distribution center, particularly during busy periods such as the back-to-school and winter holiday seasons. There can be no assurance that we will receive adequate assistance from our temporary personnel, or that there will be sufficient sources of temporary personnel.

Although none of our employees is currently covered by collective bargaining agreements, we cannot guarantee that our employees will not elect to be represented by labor unions in the future, which could increase our labor costs and could subject us to the risk of work stoppages and strikes. Any such failure to meet our staffing needs, any material increases in employee turnover rates, any increases in labor costs or any work stoppages or interruptions or strikes could have a material adverse effect on our business or results of operations.

Our operations, including our sole distribution center, are concentrated in the western United States, which makes us susceptible to adverse conditions in this region.

Our home office and sole distribution center are located in a single facility in Washington, and a substantial number of our stores are located in Washington and the western half of the United States. As a result, our business may be more susceptible to regional factors than the operations of more geographically diversified competitors. These factors include, among others, economic and weather conditions, demographic and population changes and fashion tastes. In addition, we rely on a single distribution center in Everett, Washington to receive, store and distribute merchandise to all of our stores and to fulfill our Internet sales. As a result, a natural disaster or other catastrophic event, such as an earthquake affecting western Washington, in particular, or the West Coast, in general, could significantly disrupt our operations and have a material adverse effect on our business, results of operations and financial condition.

We are required to make substantial rental payments under our operating leases and any failure to make these lease payments when due would likely have a material adverse effect on our business and growth plans.

We do not own any of our retail stores or our combined home office and distribution center, but instead we lease all of these facilities under operating leases. Payments under these operating leases account for a significant portion of our operating expenses. For example, total rental expense, including additional rental payments (or percentage rent) based on sales of some of the stores, common area maintenance charges and real estate taxes, under operating leases was $13.0 million and $9.6 million for the six months ended July 29, 2006 and July 30, 2005, respectively, and $13.9 million, $17.1 million and $22.2 million for fiscal 2003, 2004 and 2005, respectively, and, as of July 29, 2006, we were a party to operating leases requiring future minimum lease payments aggregating approximately $73.7 million through fiscal year 2010 and approximately $52.2 million thereafter. In addition, substantially all of our store leases provide for additional rental payments based on sales of the respective stores, as well as common area maintenance charges, and require that we pay real estate taxes, none of which is included in the amount of future minimum lease payments. We expect that any new stores we open will also be leased by us under operating leases, which will further increase our operating lease expenses.

Our substantial operating lease obligations could have significant negative consequences, including:

- increasing our vulnerability to general adverse economic and industry conditions;

- limiting our ability to obtain additional financing;

- requiring that a substantial portion of our available cash be applied to pay our rental obligations, thus reducing cash available for other purposes;

- limiting our flexibility in planning for or reacting to changes in our business or in the industry in which we compete; and

- placing us at a disadvantage with respect to some of our competitors.

We depend on cash flow from operations to pay our lease expenses and to fulfill our other cash needs. If our business does not generate sufficient cash flow from operating activities, and sufficient funds are not otherwise available to us from the remaining proceeds of our initial public offering, borrowings under bank loans or from other sources, we may not be able to service our operating lease expenses, grow our business, respond to competitive challenges or to fund our other liquidity and capital needs, which would have a material adverse effect on us.

The terms of our revolving credit facility impose operating and financial restrictions on us that may impair our ability to respond to changing business and economic conditions. This impairment could have a significant adverse impact on our business.

At the end of the quarter ended July 29, 2006 we have a $20 million revolving credit facility with Bank of America, N.A., which we use for inventory financing and other general corporate purposes, that contains a number of significant restrictions and covenants that generally limit our ability to, among other things, (1) incur additional indebtedness or certain lease obligations outside the ordinary course of business; (2) enter into sale/leaseback transactions; (3) make certain changes in our management; and (4) undergo a change in ownership. In addition, our obligations under the revolving credit facility are secured by almost all of our personal property, including, among other things, our inventory, equipment and fixtures. Our revolving credit facility also contains financial covenants that require us to meet certain specified financial ratios, including a debt to earnings ratio, an earnings to interest expense ratio and an inventory to debt ratio. Our ability to comply with these ratios may be affected by events beyond our control.

A breach of any of these restrictive covenants or our inability to comply with the required financial ratios could result in a default under the revolving credit facility. If a default occurs, the lender may elect to declare all borrowings outstanding, together with accrued interest and other fees, to be immediately due and payable. If we are unable to repay outstanding borrowings when due, whether at their maturity or if declared due and payable by the lender following a default, the lender has the right to proceed against the collateral granted to it to secure the indebtedness. As a result, any breach of these covenants or failure to comply with these ratios could have a material adverse effect on us. There can be no assurance that we will not breach the covenants or fail to comply with the ratios in our revolving credit facility or any other debt agreements we may enter into in the future and, if a breach occurs, there can be no assurance that we will be able to obtain necessary waivers or amendments from the lenders.

The restrictions contained in our revolving credit facility could: (1) limit our ability to plan for or react to market conditions or meet capital needs or otherwise restrict our activities or business plans; and (2) adversely affect our ability to finance our operations, strategic acquisitions, investments or other capital needs or to engage in other business activities that would be in our interest.

Our business could suffer as a result of United Parcel Service being unable to distribute our merchandise.

We rely upon United Parcel Service for our product shipments, including shipments to, from and between our stores. Accordingly, we are subject to risks, including employee strikes and inclement weather, which may affect United Parcel Service s ability to meet our shipping needs. Among other things, any circumstances that require us to use other delivery services for all or a portion of our shipments could result in increased costs and delayed deliveries and could harm our business materially. In addition, although we have a contract with United Parcel Service that expires in June 2008, United Parcel Service has the right to terminate the contract upon 30 days written notice. Although the contract with United Parcel Service provides certain discounts from the shipment rates in effect at the time of shipment, the contract does not limit United Parcel Services ability to raise the shipment rates at any time.

Accordingly, we are subject to the risk that United Parcel Service may increase the rates they charge, that United Parcel Service may terminate their contract with us, that United Parcel Service may decrease the rate discounts provided to us when an existing contract is renewed or that we may be unable to agree on the terms of a new contract with United Parcel Service, any of which could materially adversely affect our operating results.

Our business could suffer if a manufacturer fails to use acceptable labor practices.

We do not control our vendors or the manufacturers that produce the products we buy from them, nor do we control the labor practices of our vendors and these manufacturers. The violation of labor or other laws by any of our vendors or these manufacturers, or the divergence of the labor practices followed by any of our vendors or these manufacturers from those generally accepted as ethical in the United States, could interrupt, or otherwise disrupt, the shipment of finished products to us or damage our reputation. Any of these, in turn, could have a material adverse effect on our financial condition and results of operations. In that regard, most of the products sold in our stores are manufactured overseas, primarily in Asia and Central America, which may increase the risk that the labor practices followed by the manufacturers of these products may differ from those considered acceptable in the United States.

Our failure to adequately anticipate a correct mix of private label merchandise may have a material adverse effect on our business.

Sales from private label merchandise accounted for 12.9% of our net sales in fiscal 2005. We may take steps to increase the percentage of net sales of private label merchandise in the future, although there can be no assurance that we will be able to achieve increases in private label merchandise sales as a percentage of net sales. Because our private label merchandise generally carries higher gross margins than other merchandise, our failure to anticipate, identify and react in a timely manner to fashion trends with our private label merchandise, particularly if the percentage of net sales derived from private label merchandise increases, may have a material adverse effect on our comparable store sales, financial condition and results of operations.

Most of our merchandise is produced by foreign manufacturers; therefore the availability and costs of these products may be negatively affected by risks associated with international trade and other international conditions.

Most of our merchandise is produced by manufacturers in Asia and Central America. Some of these facilities are also located in regions that may be affected by natural disasters, political instability or other conditions that could cause a disruption in trade. Trade restrictions such as increased tariffs or quotas, or both, could also affect the importation of merchandise generally and increase the cost and reduce the supply of merchandise available to us. Any reduction in merchandise available to us or any increase in its cost due to tariffs, quotas or local issues that disrupt trade could have a material adverse effect on our results of operations. Although the prices charged by vendors for the merchandise we purchase are all denominated in United States dollars, a continued decline in the relative value of the United States dollar to foreign currencies could lead to increased merchandise costs, which could negatively affect our competitive position and our results of operation.

If our information systems hardware or software fails to function effectively or does not scale to keep pace with our planned growth, our operations could be disrupted and our financial results could be harmed.

Over the past several years, we have made improvements to our existing hardware and software systems, as well as implemented new systems. If these or any other information systems and software do not work effectively, this could adversely impact the promptness and accuracy of our transaction processing, financial accounting and reporting and our ability to manage our business and properly forecast operating results and cash requirements. To manage the anticipated growth of our operations and personnel, we may need to continue to improve our operational and financial systems, transaction processing, procedures and controls, and in doing so could incur substantial additional expenses which could harm our financial results. In addition, as discussed below, we will be required to improve our financial and managerial controls, reporting systems and procedures to comply with Section 404 of the Sarbanes-Oxley Act of 2002.

Our inability or failure to protect our intellectual property or our infringement of other s intellectual property could have a negative impact on our operating results.

We believe that our trademarks and domain names are valuable assets that are critical to our success. The unauthorized use or other misappropriation of our trademarks or domain names could diminish the value of the Zumiez brand, our store concept, our private label brands or our goodwill and cause a decline in our net sales. At this time, we have not secured protection for our trademarks in any jurisdiction outside of the United States, and thus we cannot prevent other persons from using our trademarks outside of the United States, which also could materially adversely affect our business. We are also subject to the risk that we may infringe on the intellectual property rights of third parties. Any infringement or other intellectual property claim made against us, whether or not it has merit, could be time-consuming, result in costly litigation, cause product delays or require us to pay royalties or license fees. As a result, any such claim could have a material adverse effect on our operating results.

The effects of war or acts of terrorism could adversely affect our business.

Substantially all of our stores are located in shopping malls. Any threat of terrorist attacks or actual terrorist events, particularly in public areas, could lead to lower customer traffic in shopping malls. In addition, local authorities or mall management could close shopping malls in response to security concerns. Mall closures, as well as lower customer traffic due to security concerns, would likely result in decreased sales. Additionally, the escalation of the armed conflicts in the Middle East, or the threat, escalation or commencement of war or other armed conflict elsewhere, could significantly diminish consumer spending, and result in decreased sales for us. Decreased sales would have a material adverse effect on our business, financial condition and results of operations.

Failure to successfully integrate any businesses or stores that we acquire could have an adverse impact on our results of operations and financial performance.

We may from time to time acquire other retail stores, individually or in groups, or businesses. In particular, in June 2006 we completed the acquisition of the Fast Forward sporting goods store chain. We may experience difficulties in assimilating any stores or businesses we may acquire, including the Fast Forward operations, and any such acquisitions may also result in the diversion of our capital and our management s attention from other business issues and opportunities. We may not be able to successfully integrate any stores or businesses that we may acquire, including their facilities, personnel, financial systems, distribution, operations and general operating procedures. If we fail to successfully integrate acquisitions or if such acquisitions fail to provide the benefits that we expect to receive, we could experience increased costs and other operating inefficiencies, which could have an adverse effect on our results of operations and financial performance.

The outcome of litigation could have a material adverse effect on our business.

We are involved, from time to time, in litigation incidental to our business. Management believes, after considering a number of factors and the nature of the legal proceedings to which we are subject, that the outcome of current litigation is not expected to have a material adverse effect upon our results of operations or financial condition. However, management s assessment of our current litigation could change in light of the discovery of facts not presently known to us or determinations by judges, juries or other finders of fact that are not in accord with management s evaluation of the possible liability or outcome of such litigation. As a result, there can be no assurance that the actual outcome of pending or future litigation will not have a material adverse effect on our results of operations or financial condition.

Our Internet operations subject us to numerous risks that could have an adverse effect on our results of operations.

Although Internet sales constitute a small portion of our overall sales, our Internet operations subject us to certain risks that could have an adverse effect on our operational results, including:

- diversion of traffic and sales from our stores;

- liability for online content; and
- risks related to the computer systems that operate our website and related support systems, including computer viruses and electronic break-ins and similar disruptions.

In addition, risks beyond our control, such as governmental regulation of the Internet, entry of our vendors in the Internet business in competition with us, online security breaches and general economic conditions specific to the Internet and online commerce could have an adverse effect on our results of operations.

We have incurred and will continue to incur significant expenses as a result of being a public company, which will negatively impact our financial performance.

We completed our initial public offering in May 2005 and we have incurred and will continue to incur significant legal, accounting, insurance and other expenses as a result of being a public company. The Sarbanes-Oxley Act of 2002, as well as related rules implemented by the SEC and The Nasdaq Stock Market, have required changes in corporate governance practices of public companies. We expect that compliance with these laws, rules and regulations, including compliance with Section 404 of the Sarbanes-Oxley Act as discussed in the following risk factor, will substantially increase our expenses, including our legal and accounting costs, and make some activities more time-consuming and costly. We also expect these laws, rules and regulations to make it more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors or as officers. As a result of the foregoing, we expect a substantial increase in legal, accounting, insurance and certain other expenses in the future, which will negatively impact our financial performance and could have a material adverse effect on our results of operations and financial condition.

Failure to maintain adequate financial and management processes and controls could lead to errors in our financial reporting and could harm our ability to manage our expenses.

Reporting obligations as a public company and our anticipated growth are likely to place a considerable strain on our financial and management systems, processes and controls, as well as on our personnel. In addition, as a public company we will be required to document and test our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 so that our management can certify as to the effectiveness of our internal controls and our independent registered public accounting firm can render an opinion on management s assessment and on the effectiveness of our internal control over financial reporting by the time our annual report for fiscal 2006 is due and thereafter, which will require us to document and make significant changes to our internal controls over financial reporting. As a result, we may be required to improve our financial and managerial controls, reporting systems and procedures, to incur substantial expenses to test our systems and to make such improvements and to hire additional personnel. If our management is unable to certify the effectiveness of our internal controls or if our independent registered public accounting firm cannot render an opinion on management s assessment and on the effectiveness of our internal control over financial reporting, or if material weaknesses in our internal controls are identified, we could be subject to regulatory scrutiny and a loss of public confidence, which could have a material adverse effect on our business and our stock price. In addition, if we do not maintain adequate financial and management personnel, processes and controls, we may not be able to

accurately report our financial performance on a timely basis, which could cause a decline in our stock price and adversely affect our ability to raise capital.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

During different times of the year, due to the seasonality of our business, we may borrow under our revolving credit facility. To the extent we borrow under our revolving credit facility, which bears interests at floating rates based either on the prime rate or LIBOR, we are exposed to market risk related to changes in interest rates. At July 29, 2006, we had no borrowings outstanding under our credit facility. We are not a party to any derivative financial instruments.

Item 4: Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)). Based on this evaluation, our CEO and CFO concluded that, as of July 29, 2006, our disclosure controls and procedures were effective.

Disclosure controls and procedures, no matter how well designed and implemented, can provide only reasonable assurance of achieving an entity s disclosure objectives. The likelihood of achieving such objectives is affected by limitations inherent in disclosure controls and procedures. These include the fact that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human failures such as simple errors or mistakes or intentional circumvention of the established process.

Changes in Internal Control Over Financial Reporting. There has been no change in our internal control over financial reporting (as defined in Securities Exchange Act Rule 13a-15(f)) during the quarter ended April 29, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved from time to time in litigation incidental to our business. We believe that the outcome of current litigation will not have a material adverse effect on our results of operations or financial condition.

See Note 4 to the Notes to Consolidated Financial Statements found in Item 1 of this Form 10-Q (listed under Litigation under Commitments and Contingencies).

Item 2. Changes in Securities; Use of Proceeds and Issuer Purchases of Equity Securities

(b) Use of Proceeds

Our registration statement on Form S-1 under the Securities Act of 1933 (File No. 333-122865), relating to our initial public offering of common stock was declared effective by the Securities and Exchange Commission on May 5, 2005 and we completed our initial public offering on May 11, 2005. We received net proceeds from the offering of approximately $29.7 million, after payment of underwriting discounts and commissions and offering expenses. Since the completion of the offering, we have used approximately $29.7 million, to pay down balances on our line of credit, to fund capital expenditures associated with opening new stores, and to fund the Fast Forward acquisition.

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

At our Annual Meeting of Shareholders held on May 31, 2006, the following proposal was adopted by the following number of votes:

Proposal Number One: The election of three directors to hold office until the 2009 Annual Meeting of Shareholders. Each of the following nominees for director were elected to serve for a three-year term, by the following margins of votes:

Nominees	**For**	**Withheld**
Richard M. Brooks	13,076,253	209,861
Matthew L. Hyde	13,200,597	85,517
James M. Weber	13,200,597	85,517

Item 5. Other Information

None

Item 6. Exhibits

Exhibits

Exhibit No.	**Description of Exhibits**
10.12	Equity Purchase Agreement with Gerald R. Anderson, Brandon C. Batton, AC Fast Forward LLC and AC Fast Forward Mgt., LLC dated May 16, 2006.
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

ZUMIEZ INC.

By: /s/ BRENDA I. MORRIS
Brenda I. Morris
Chief Financial Officer

Dated: September 12, 2006