

BIG 5 SPORTING GOODS CORP

Form 10-K/A

October 25, 2004

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K/A

Amendment No. 1

**FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 28, 2003

OR

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

For the transition period from to

Commission file number: 000-49850

Big 5 Sporting Goods Corporation

(Exact name of registrant as specified in its charter)

Delaware

*(State or Other Jurisdiction of
Incorporation or Organization)*

95-4388794

*(I.R.S. Employer
Identification No.)*

**2525 East El Segundo Boulevard
El Segundo, California**

(Address of Principal Executive Offices)

90245

(Zip Code)

Registrant's telephone number, including area code:

(310) 536-0611

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value \$.01 per share

(Title of Class)

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 on Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or in any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$133,669,171.90 as of June 27, 2003 (the last business day of the registrant's most recently completed second fiscal quarter) based upon the closing price of the registrant's common stock on the Nasdaq National Market reported for June 27, 2003. Shares of common stock held by each executive officer and director and by each person who, as of such date, may be deemed to have beneficially owned more than 5% of the outstanding voting stock have been excluded in that such persons may be deemed to be affiliates of the registrant under certain circumstances. This determination of affiliate status is not necessarily a conclusive determination of affiliate status for any other purpose.

22,664,627 shares of the registrant's common stock, par value \$0.01 per share, were outstanding at March 5, 2004.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference certain information from the registrant's definitive proxy statement (the Proxy Statement) for its annual meeting of shareholders to be held on June 3, 2004.

TABLE OF CONTENTS

PART II

Item 6: Selected Consolidated Financial and Other Data

Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations

PART IV

Item 15: Exhibits, Financial Statement Schedules, and Reports on Form 8-K

SIGNATURES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

EXHIBIT 23.1

EXHIBIT 31.1

EXHIBIT 31.2

EXHIBIT 32.1

EXHIBIT 32.2

Table of Contents

EXPLANATORY NOTE

On March 12, 2004, Big 5 Sporting Goods Corporation filed its Annual Report on Form 10-K for the fiscal year ending December 28, 2003 (the Original Filing) with the Securities and Exchange Commission (the SEC). The Company hereby amends Items 6 and 7 of the Original Filing, and the notes to the consolidated financial statements, to respond to comments the Company received from the SEC with respect to the Original Filing.

This report continues to speak as of the date of the Original Filing, and the Company has not updated the disclosures in this report to speak as of a later date. Updated information regarding recent developments is included in the Company's other filings with the SEC and in press releases issued by the Company.

Table of Contents**PART II****Item 6: Selected Consolidated Financial and Other Data**

The selected data presented below under the captions *Statements of Operations Data* and *Balance Sheet Data* for, and as of the end of the fiscal years ended December 31, 2000, December 30, 2001, December 29, 2002 and December 28, 2003 are derived from our audited consolidated financial statements, which financial statements have been audited by KPMG LLP, independent registered public accounting firm. The selected data presented below under the captions *Statement of Operations* and *Balance Sheet Data* for, and as of the end of the fiscal year ended January 2, 2000 have been derived from our consolidated financial statements and have been reclassified to conform with the adoption of Statement of Financial Accounting Standards No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections. The consolidated financial statements as of December 29, 2002 and December 28, 2003 and for each of the years ended December 29, 2002 and December 28, 2003 and the report thereon are included elsewhere in this report. The information presented below under the captions *Store Data* and *Other Financial Data* is unaudited. You should read the following tables in conjunction with the consolidated financial statements and accompanying notes and *Management's Discussion and Analysis of Financial Condition and Results of Operations* appearing elsewhere in this report.

	Fiscal Year(1)				
	1999	2000	2001	2002	2003
(Dollars and shares in thousands, except per share and store data)					
Statement of Operations Data:					
Net sales	\$ 514,324	\$ 571,476	\$ 622,481	\$ 667,469	\$ 709,740
Cost of goods sold, buying and occupancy	341,852	377,040	407,679	429,858	453,814
Gross profit	172,472	194,436	214,802	237,611	255,926
Operating expenses:					
Selling and administrative	131,222	144,703	160,044	174,868	186,798
Litigation settlement			2,515		
Depreciation and amortization	9,479	9,340	10,031	9,966	10,412
Total operating expenses	140,701	154,043	172,590	184,834	197,210
Operating income	31,771	40,393	42,212	52,777	58,716
Premium (discount) and unamortized financing fees related to redemption of debt	621	(148)	(2,662)	4,557	3,434
Interest expense, net	21,574	22,008	19,629	15,825	11,405
Income before income taxes	9,576	18,533	25,245	32,395	43,877
Income taxes	3,751	7,385	10,280	13,313	17,587
Net income	5,825	11,148	14,965	19,082	26,290
Redeemable preferred stock dividends	5,621	6,400	7,284	7,999	
Net income available to common stockholders	\$ 204	\$ 4,748	\$ 7,681	\$ 11,083	\$ 26,290
Earnings per share:					
Basic	\$ 0.02	\$ 0.35	\$ 0.54	\$ 0.60	\$ 1.16

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Diluted	\$ 0.01	\$ 0.30	\$ 0.48	\$ 0.57	\$ 1.16
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Table of Contents

	Fiscal Year(1)				
	1999	2000	2001	2002	2003
(Dollars and shares in thousands, except per share and store data)					
Shares used to calculate earnings per share:					
Basic	12,801	13,525	14,247	18,358	22,651
Diluted	16,098	16,094	16,090	19,476	22,753

	Fiscal Year(1)				
	1999	2000	2001	2002	2003
(Dollars and shares in thousands, except per share and store data)					
Store Data:					
Same store sales increase(2)	2.0%	6.6%	4.9%	4.0%	2.2%
Net sales per gross square foot(3)	\$ 203	\$ 217	\$ 224	\$ 227	\$ 227
End of period stores	234	249	260	275	293
Average net sales per store(4)	\$ 2,285	\$ 2,405	\$ 2,448	\$ 2,541	\$ 2,546
Other Financial Data:					
Gross margin	33.5%	34.0%	34.5%	35.6%	36.1%
Capital expenditures	\$ 13,075	\$ 11,602	\$ 10,510	\$ 10,207	\$ 10,489
Inventory turns(5)	2.1x	2.2x	2.4x	2.5x	2.7x
Balance Sheet Data:					
Cash and cash equivalents	\$ 5,091	\$ 3,753	\$ 7,865	\$ 9,441	\$ 9,030
Working capital(6)	\$ 71,289	\$ 69,427	\$ 66,292	\$ 72,767	\$ 74,403
Total assets	\$234,917	\$254,433	\$253,883	\$257,975	\$272,025
Total debt	\$178,446	\$172,098	\$153,351	\$125,131	\$ 99,686
Redeemable preferred stock	\$ 45,408	\$ 51,721	\$ 58,911		
Stockholders equity (deficit)	\$ (96,851)	\$ (92,105)	\$ (84,425)	\$ 3,674	\$ 29,964

(Notes to table on previous page and this page)

- (1) Our fiscal year is the 52 or 53-week reporting period ending on the Sunday closest to the calendar year end. All years presented consisted of 52 weeks.
- (2) Same store sales data for a fiscal year presented reflects stores open throughout that fiscal year and the prior fiscal year.
- (3) Net sales per gross square foot is calculated by dividing net sales for stores open the entire period by the total gross square footage for those stores.
- (4) Average net sales per store is calculated by dividing net sales for stores open the entire period by total store count for stores open the entire period.
- (5) Inventory turns equal fiscal year cost of goods sold, buying and occupancy costs divided by fiscal year four-quarter average FIFO (first-in, first-out) inventory balances.
- (6) Working capital is defined as current assets less current liabilities.

Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations

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Throughout this section, our fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003 are referred to as fiscal 2001, fiscal 2002 and fiscal 2003, respectively. The following discussion and analysis of our financial condition and results of operations for fiscal 2001, fiscal 2002 and fiscal 2003 should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this report. Some of the information contained in this discussion and analysis or set forth elsewhere in this report, including information with respect to our plans and strategies for our business, includes forward-

Table of Contents

looking statements that involve risk and uncertainties. You should review the Risk Factors set forth elsewhere in this report for a discussion of important factors that could cause actual results in future periods to differ materially from the results contemplated by the forward- looking statements contained herein.

Overview

We are the leading sporting goods retailer in the western United States, operating 293 stores in 10 states under the name Big 5 Sporting Goods at December 28, 2003. We provide a full-line product offering in a traditional sporting goods store format that averages 11,000 square feet. Our product mix includes athletic shoes, apparel and accessories, as well as a broad selection of outdoor and athletic equipment for team sports, fitness, camping, hunting, fishing, tennis, golf, snowboarding and in-line skating. We believe over the past 49 years we have developed a reputation with the competitive and recreational sporting goods customer as a convenient neighborhood sporting goods retailer that delivers consistent value on quality merchandise.

Throughout our 49-year history, we have emphasized controlled growth. The following table summarizes our store count for the periods presented:

	Fiscal Year		
	2001	2002	2003
Big 5 Sporting Goods stores			
Beginning of period	249	260	275
New stores(1)	15	15	19
Stores relocated	(4)		
Stores closed			(1)
	—	—	—
End of period	260	275	293

(1) Stores that are relocated during any period are classified as new stores.

Basis of Reporting**Net Sales**

Net sales consist of sales from all stores operated during the period presented, net of actual returns during such period. Actual returns were \$38.4 million, \$50.5 million and \$52.6 million for the fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003, respectively. The Company does not maintain a sales return allowance. The difference between recording actual sales returns and establishing an allowance for sales returns is not considered to have a material impact on the Company's financial statements for the periods presented. Same store sales for a period reflect net sales from stores operated throughout that period as well as the corresponding prior period. New store sales for a period reflect net sales from stores opened in that period as well as net sales from stores opened during the prior fiscal year. Stores that are relocated during any period are treated as new stores.

Gross Profit

Gross profit is comprised of net sales less all costs of sales, including the cost of merchandise, inventory markdowns, inventory shrinkage, inbound freight, distribution and warehousing, payroll for our buying personnel and store and corporate office occupancy costs. Store and corporate office occupancy costs include rent, contingent rents, common area maintenance, real estate property taxes and property insurance.

Selling and Administrative

Selling and administrative includes store management and corporate expenses, including non-buying personnel payroll, employment taxes, employee benefits, management information systems, advertising, insurance other than property insurance, legal, store pre-opening expenses and other corporate level expenses. Store pre-opening expenses include store-level payroll, grand opening event marketing, travel, supplies and other

store opening expenses.

Table of Contents

Depreciation and Amortization

Depreciation and amortization consists primarily of the depreciation of leasehold improvements, fixtures and equipment owned by us, amortization of leasehold interest and goodwill (for periods prior to fiscal 2002) and non-cash rent expense.

Discussion of Critical Accounting Policies

In the ordinary course of business, we have made a number of estimates and assumptions relating to the reporting of results of operations and financial condition in the preparation of our financial statements in conformity with accounting principles generally accepted in the United States. Actual results could differ significantly from those estimates under different assumptions and conditions. We believe that the following discussion addresses our critical accounting policies, which are those that are most important to the portrayal of our financial condition.

Valuation of Inventory

We value our inventories at the lower of cost or market using the weighted average cost method that approximates the first-in, first-out (FIFO) method. Management has evaluated the current level of inventories in comparison to planned sales volume and other factors and, based on this evaluation, has recorded adjustments to inventory and cost of goods sold for estimated decreases in inventory value. These adjustments are estimates, which could vary significantly, either favorably or unfavorably, from actual results if future economic conditions, consumer demand and competitive environments differ from our expectations. We are not aware of any events or changes in demand or price that would indicate to us that our inventory valuation may be materially inaccurate at this time.

Valuation of Long-Lived Assets

Long-lived assets and certain identifiable intangibles are reviewed 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 measured by a comparison of the carrying amount of the assets to future net cash flows estimated by us to be generated by these assets. If such assets are considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the assets exceeds the fair value of the assets. We are not aware of any events or changes in circumstances that would indicate to us that our long-lived assets are impaired or that would require an impairment consideration at this time.

Table of Contents**Results of Operations**

The following table sets forth selected items from our statements of operations as a percentage of our net sales for the periods indicated:

	Fiscal Year		
	2001	2002	2003
Statement of Operations Data:			
Net sales	100.0%	100.0%	100.0%
Costs of sales	65.5	64.4	63.9
Gross profit	34.5	35.6	36.1
Selling and administrative	25.7	26.2	26.3
Litigation settlement	0.4		
Depreciation and amortization	1.6	1.5	1.5
Operating income	6.8	7.9	8.3
Premium (discount) and unamortized financing fees related to redemption of debt	(0.4)	0.7	0.5
Interest expense, net	3.2	2.4	1.6
Income before income tax expense	4.0	4.8	6.2
Income tax expense	1.6	1.9	2.5
Net income	2.4%	2.9%	3.7%

Fiscal 2003 Compared to Fiscal 2002

Net Sales. Net sales increased by \$42.3 million, or 6.3%, to \$709.7 million in fiscal 2003 from \$667.5 million in fiscal 2002. This growth reflected an increase of \$14.3 million in same store sales and an increase of \$28.4 million in new store sales, which resulted from the opening of 19 new stores during fiscal 2003 and 15 new stores during fiscal 2002. The remaining variance was attributable to net sales from closed stores. Same store sales increased 2.2% for fiscal 2003 versus fiscal 2002. The increase in same store sales was primarily attributable to higher sales in each of our three major product categories of footwear, hard goods and apparel. Store count at the end of fiscal 2003 was 293 versus 275 at the end of fiscal 2002 as we opened 19 new stores and closed one store. We achieved positive same store sales of 3.6% during the fourth quarter of fiscal 2003, representing the thirty-second consecutive quarter of positive quarterly same store sales results.

Gross Profit. Gross profit increased by \$18.3 million, or 7.7%, to \$255.9 million in fiscal 2003 from \$237.6 million in fiscal 2002. Gross profit margin was 36.1% in fiscal 2003 compared to 35.6% in fiscal 2002. We were able to achieve higher gross profit margins primarily due to improved selling margins in each of our three major product categories, partially offset by a 0.3% increase in occupancy and distribution center costs when measured as a percentage of sales.

Selling and Administrative. Selling and administrative expenses increased by \$11.9 million, or 6.8%, to \$186.8 million in fiscal 2003 from \$174.9 million in fiscal 2002. The increase was driven by a \$9.2 million increase in store-related expenses primarily resulting from the need to support our store growth, increased employee health benefit costs, increased workers' compensation costs and higher credit and debit card fees related to increased use of credit and debit cards by our customers. Our advertising expenses increased by \$2.9 million due to our store growth and a printing cost credit recorded in the third quarter of fiscal 2002. During fiscal 2003, legal, audit, and public liability insurance, including directors and officers insurance, increased by \$2.1 million versus fiscal 2002 largely as a result of our public company reporting requirements after our IPO in 2002. These absolute and percentage increases in selling and administrative expenses were not as high as they otherwise might have been, because during fiscal 2002 we incurred expenses in connection with our IPO. These expenses included management services agreement fees and termination costs paid to Leonard Green & Associates, L.P., an affiliate of Leonard Green & Partners, L.P., which were \$1.0 million in

Table of Contents

fiscal 2002, as well as bonuses paid to our executive officers and directors during fiscal 2002. The bonuses totaled \$2.0 million and were funded through a reduction of the redemption price that would otherwise have been applicable to the redemption of our outstanding preferred stock. Selling and administrative expenses when measured as a percentage of net sales were 26.2% for fiscal 2002, reflecting the impact of the expenses incurred in connection with our IPO described above.

Depreciation and Amortization. Depreciation and amortization expense increased by \$0.4 million in fiscal 2003 compared to fiscal 2002 primarily due to the increase in store count to 293 stores at the end of fiscal 2003 from 275 stores at the end of fiscal 2002.

Premium (Discount) and Unamortized Financing Fees Related to Redemption of Debt. Premium and unamortized financing fees related to redemption of debt were \$3.4 million in fiscal 2003 versus \$4.6 million in fiscal 2002. The \$3.4 million charge in fiscal 2003 resulted from a \$2.4 million premium related to the redemption of \$55.0 million face value of our 10.875% senior notes and the related carrying value of applicable deferred financing costs and original issue discount which totaled \$1.0 million in fiscal 2003. The \$4.6 million charge in fiscal 2002 resulted from the repurchase of \$2.8 million face value of our senior discount notes and \$1.0 million face value of our 10.875% senior notes in fiscal 2002 and the redemption of all of our remaining senior discount notes for an aggregate redemption price of approximately \$27.5 million in the third quarter of fiscal 2002 following our IPO. The \$4.6 million charge consists of \$4.0 million in redemption premium and \$0.6 million in unamortized deferred financing costs associated with the related debt.

Interest Expense, net. Interest expense, net decreased by \$4.4 million, or 27.9%, to \$11.4 million in fiscal 2003 from \$15.8 million in fiscal 2002. This decrease reflected lower average daily debt balances and lower average interest rates on our credit facility in fiscal 2003 versus fiscal 2002, as well as lower average interest costs associated with using borrowings from our credit facility to redeem \$55.0 million of our 10.875% senior notes in fiscal 2003. In fiscal 2002, we used some of the proceeds from our IPO to redeem all of our outstanding senior discount notes for an aggregate redemption price of approximately \$27.5 million. Accordingly, interest expense, net, included no interest expenses related to those senior discount notes in fiscal 2003 versus \$2.1 million in fiscal 2002.

Income Taxes. Provision for income taxes was \$17.6 million for fiscal 2003 and \$13.3 million for fiscal 2002. The Company accrues taxes at the statutory tax rate, which is reevaluated on an ongoing basis by management. In fiscal 2003 we determined the Company's effective tax rate to be 40.1% down from 41.1% in fiscal 2002, due in part to the growth in our store base outside of California.

Fiscal 2002 Compared to Fiscal 2001

Net Sales. Net sales increased by \$45.0 million, or 7.2%, to \$667.5 million in fiscal 2002 from \$622.5 million in fiscal 2001. This growth reflected an increase of \$24.0 million in same store sales and an increase of \$23.8 million in new store sales, which reflected the opening of 15 new stores during each of fiscal 2002 and fiscal 2001. The remaining variance was attributable to net sales from relocated stores. Same store sales increased 4.0% for fiscal 2002 versus fiscal 2001. The increase in same store sales was primarily attributable to higher sales in the majority of our merchandise categories. Store count at the end of fiscal 2002 was 275 versus 260 at the end of fiscal 2001 as we opened 15 new stores. We achieved positive same store sales of 0.4% during the fourth quarter of fiscal 2002.

Gross Profit. Gross profit increased by \$22.8 million, or 10.6%, to \$237.6 million in fiscal 2002 from \$214.8 million in fiscal 2001. Gross profit margin was 35.6% in fiscal 2002 compared to 34.5% in fiscal 2001. We were able to achieve higher gross profit margins primarily due to improved selling margins in the majority of our product categories, including favorable comparisons throughout our footwear and apparel categories. Improved margins in our skate category after the sale of excess scooter inventory in fiscal 2001 was the primary factor resulting in improved margins in our hard goods categories.

Selling and Administrative. Selling and administrative expenses increased by \$14.9 million, or 9.3%, to \$174.9 million in fiscal 2002 from \$160.0 million in fiscal 2001. The increase was primarily due to a \$9.1 million increase in store-related expenses associated with supporting increased sales, new store openings

Table of Contents

and increased employee health benefit costs and increased expenses due to electric utility rate increases in our California markets. Other factors impacting the increase included an increase of \$1.2 million in advertising costs that resulted primarily from advertising expenditures for the 15 new stores opened in 2002 and the 15 new stores opened in 2001 and higher insurance related costs of \$0.6 million primarily related to increased directors and officers insurance premiums after our IPO. The remaining increase in selling and administrative expenses resulted primarily from expenses incurred in connection with our IPO. These expenses include termination costs associated with our management services agreement with Leonard Green & Associates, L.P., an affiliate of Leonard Green & Partners, L.P., which were \$0.9 million in 2002, as well as bonuses relating to our initial public offering paid to our executive officers and directors in 2002. The bonuses for that period totaled \$2.0 million and were funded through a reduction of the redemption price that would otherwise have been applicable to redemption of our outstanding preferred stock. Selling and administrative expenses when measured as a percentage of net sales were 26.2% for fiscal 2002 versus 25.7% for fiscal 2001 reflecting the impact of the expenses incurred in connection with our IPO.

Depreciation and Amortization. Depreciation and amortization expense decreased by \$0.1 million in fiscal 2002 compared to fiscal 2001 as a result of the implementation of SFAS No. 142, *Goodwill and Other Intangible Assets*, effective December 31, 2001, which reduced amortization expense by \$0.1 million in 2002.

Premium (Discount) and Unamortized Financing Fees Related to Redemption of Debt. Premium and unamortized financing fees related to redemption of debt were \$4.6 million in fiscal 2002 versus a discount of \$2.7 million in fiscal 2001. The \$4.6 million charge in fiscal 2002 resulted from the repurchase of \$2.8 million face value of our senior discount notes and \$1.0 million face value of our 10.875% senior notes in fiscal 2002 and redemption of all of our remaining senior discount notes for an aggregate redemption price of approximately \$27.5 million in the third quarter of fiscal 2002 following our IPO. The \$4.6 million charge consists of \$4.0 million in redemption premium and \$0.6 million in unamortized deferred financing costs associated with the related debt. The \$2.7 million gain in fiscal 2001 resulted from the repurchase of \$12.5 million face value of our senior discount notes.

Interest Expense, net. Interest expense, net decreased by \$3.8 million, or 19.4%, to \$15.8 million in fiscal 2002 from \$19.6 million in fiscal 2001. This decrease reflected lower average daily debt balances and lower average interest rates on our credit facility in fiscal 2002 versus fiscal 2001. In fiscal 2002, we used some of the proceeds from our IPO to redeem all of our outstanding senior discount notes for an aggregate redemption price of approximately \$27.5 million. Interest expense, net included expenses related to those senior discount notes of \$2.1 million in fiscal 2002 versus \$4.1 million in fiscal 2001.

Income Taxes. Provision for income taxes was \$13.3 million for fiscal 2002 and \$10.3 million for fiscal 2001. Our effective income tax rate was 41.1% for fiscal 2002 and 40.8% for fiscal 2001. The effective rate is subject to ongoing evaluation by management.

Liquidity and Capital Resources

Our principal liquidity requirements are for working capital and capital expenditures. We fund our liquidity requirements with cash flow from operations and borrowings under our credit facility.

Net cash provided by operating activities for fiscal 2003, fiscal 2002 and fiscal 2001 was \$32.7 million, \$32.1 million and \$31.5 million, respectively. The increases for fiscal 2003 versus fiscal 2002 and fiscal 2002 versus fiscal 2001 primarily reflected increased net income after adjustments to reconcile net income to net cash provided by operating activities which was partially offset by increased working capital requirements between periods.

Capital expenditures for fiscal 2003, fiscal 2002 and fiscal 2001 were \$10.5 million, \$10.2 million, and \$10.5 million, respectively. We expect capital expenditures for fiscal 2004 to range from \$22.0 to \$24.0 million. We expect to spend \$12.0 to \$13.0 million primarily to fund the opening of approximately 15 to 20 new stores, store improvements and remodelings, warehouse and headquarters improvements and computer hardware and software expenditures. In addition, we anticipate spending approximately \$10 to \$11 million of the anticipated

Table of Contents

\$15 million of total capital spending requirements for our planned new distribution center, which is expected to be operational in 12 to 24 months.

Net cash used in financing activities in fiscal 2003 was \$22.6 million versus net cash used in financing activities of \$20.3 million in fiscal 2002 and \$16.9 million in fiscal 2001. As of December 28, 2003, we had borrowings of \$51.7 million and letter of credit commitments of \$0.2 million outstanding under our revolving credit facility and \$48.1 million of our 10.875% senior notes outstanding. These balances compare to borrowings of \$22.3 million and letter of credit commitments of \$4.3 million outstanding under our credit facility and \$102.9 million of our 10.875% senior notes outstanding as of December 29, 2002. As of December 30, 2001, we had borrowings of \$25.0 million and letter of credit commitments of \$3.4 million outstanding under our credit facility, \$103.8 million of our 10.875% senior notes outstanding and \$25.0 million of our senior discount notes outstanding. We redeemed \$20.0 million face value of our 10.875% senior notes in the first quarter of fiscal 2003, and \$35.0 million face value in the fourth quarter of fiscal 2003 using borrowings under our revolving credit facility. We repurchased \$0.5 million face value of our 10.875% senior notes and \$2.8 million face value of our senior discount notes during the first quarter of 2002 and wholly redeemed the remainder of our senior discount notes following the consummation of our IPO during the third quarter of fiscal 2002. We repurchased an additional \$0.5 million of our 10.875% senior notes during the last quarter of fiscal 2002. During fiscal 2001 we repurchased \$12.5 million face value of our senior discount notes. We had cash of \$9.0 million, \$9.4 million and \$7.9 million at December 28, 2003, December 29, 2002, and December 30, 2001 respectively.

We believe we will be able to fund our future cash requirements for operations from operating cash flows, cash on hand and borrowings under our credit facility. We believe these sources of funds will be sufficient to continue our operations and planned capital expenditures and satisfy our scheduled payments under debt obligations for at least the next twelve months. However, our ability to satisfy such obligations depends upon our future performance, which in turn is subject to general economic conditions and regional risks, and to financial, business and other factors affecting our operations, including factors beyond our control. See Risk Factors.

Our principal future obligations and commitments as of December 28, 2003, excluding periodic interest payments, include the following:

	Payments Due by Period				
	Total	1 Year	2-3 Years	4-5 Years	After 5 Years
	(In thousands)				
Long-term debt	\$ 48,030			\$ 48,030	
Operating lease commitments	270,047	41,024	70,748	58,179	100,096
Revolving credit facility	51,656		51,656		
Letters of credit	152	152			
Total	\$369,885	\$41,176	\$122,404	\$106,209	\$100,096

Long-term debt consists of our 10.875% senior notes that mature on November 13, 2007. We expect to repay our 10.875% senior notes by the maturity date using a combination of drawings under our credit facility, an expansion or replacement of our credit facility and the issuance of debt or equity securities. The 10.875% senior notes are general unsecured obligations, which rank senior in right of payment to all of our existing and future subordinated indebtedness and *pari passu* in right of payment with all of our current and future unsubordinated indebtedness, subject to the security interests that have been granted in substantially all of our assets in connection with our credit facility.

Operating lease commitments consist principally of leases for our retail store facilities, distribution center and corporate offices. These leases frequently include options which permit us to extend the terms beyond the initial fixed lease term. We intend to renegotiate those leases as they expire. Payments for these lease commitments are provided for by cash flows generated from operations.

Table of Contents

We had a non-amortizing \$125.0 million revolving credit facility, which was amended and restated in the first quarter of fiscal 2003 to a three-year non-amortizing \$140.0 million revolving credit facility. The credit facility may be terminated by the lenders by giving at least 90 days prior written notice before any anniversary date, commencing with its anniversary date on March 20, 2006. We may terminate the credit facility by giving at least 30 days prior written notice, provided that if we terminate prior to March 20, 2006, we must pay an early termination fee. Unless it is terminated, the credit facility will continue on an annual basis from anniversary date to anniversary date beginning on March 21, 2006. The facility is secured by a first priority security interest in substantially all of our assets.

The credit facility bears interest at various rates based on our performance, with a floor of LIBOR plus 1.50% or the JP Morgan Chase Bank prime lending rate and a ceiling of LIBOR plus 2.50% or the JP Morgan Chase Bank prime lending rate plus 0.75% and is secured by trade accounts receivable, merchandise inventory and general intangible assets (including trademarks and trade names). At December 28, 2003, loans under the credit facility bear interest at a rate of LIBOR (1.15% at December 28, 2003) plus 1.50% or the JP Morgan Chase Bank prime lending rate (4.00% at December 28, 2003). An annual fee of 0.325%, payable monthly, is assessed on the unused portion of the amended and restated credit facility. On December 28, 2003, we had \$51.7 million in LIBOR and prime lending rate borrowings and letters of credit of \$0.2 million outstanding. Our maximum eligible borrowing available under the credit facility is limited to 70% of the aggregate value of eligible inventory during November through February and 65% of the aggregate value of eligible inventory during the remaining months of the year. Available borrowings over and above actual LIBOR and prime rate borrowings and letters of credit outstanding on the credit facility amounted to \$72.9 million at December 28, 2003.

Our credit facility and the indenture governing our 10.875% senior notes contain various financial and other covenants, including covenants that require us to maintain various financial ratios, restrict our ability to incur indebtedness or to create various liens and restrict the amount of capital expenditures that we may incur. Our credit facility and the indenture governing our 10.875% senior notes also restrict our ability to engage in mergers or acquisitions, sell assets or pay dividends. We are currently in compliance with all covenants under our credit facility and the indenture governing our 10.875% senior notes.

If we fail to make any required payment under our credit facility or the indenture governing our 10.875% senior notes or if we otherwise default under these instruments, our debt may be accelerated under these instruments. This acceleration could also result in the acceleration of other indebtedness that we may have outstanding at that time.

If we are unable to generate sufficient cash flow from operations to meet our obligations and commitments, we will be required to refinance or restructure our indebtedness or raise additional debt or equity capital. Additionally, we may be required to sell material assets or operations or delay or forego expansion opportunities. We might not be able to effect these alternative strategies on satisfactory terms, if at all.

Seasonality

We experience seasonal fluctuations in our net sales and operating results. In fiscal 2003, we generated 27.0% of our net sales and 35.2% of our operating income in the fourth fiscal quarter, which includes the holiday selling season as well as the peak winter sports selling season. As a result, we incur significant additional expenses in the fourth fiscal quarter due to higher purchase volumes and increased staffing. If we miscalculate the demand for our products generally or for our product mix during the fourth fiscal quarter, our net sales could decline, resulting in excess inventory, which could harm our financial performance. Because a substantial portion of our operating income is derived from our fourth fiscal quarter net sales, a shortfall in expected fourth fiscal quarter net sales could cause our annual operating results to suffer significantly.

Table of Contents

Impact of Inflation

We do not believe that inflation has a material impact on our earnings from operations.

Impact of New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (FIN No. 46), *Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51*, which addresses consolidation by business enterprises of variable interest entities (VIEs) either: (1) that do not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) in which the equity investors lack an essential characteristic of a controlling financial interest. In December 2003, the FASB completed deliberations of proposed modifications to FIN No. 46 (Revised Interpretations) resulting in multiple effective dates based on the nature as well as the creation date of the VIE. VIEs created after January 31, 2003, but prior to January 1, 2004, may be accounted for either based on the original interpretation or the Revised Interpretations. VIEs created after January 1, 2004 must be accounted for under the Revised Interpretations. Special Purpose Entities (SPEs) created prior to February 1, 2003 may be accounted for under the original or revised interpretation s provisions. Non-SPEs created prior to February 1, 2003 should be accounted for under the Revised Interpretation s provisions. The Revised Interpretations are effective for periods after June 15, 2003 for VIEs in which the Company holds a variable interest it acquired before February 1, 2003. For entities acquired or created before February 1, 2003, the Revised Interpretations are effective no later than the end of the first reporting period that ends after March 15, 2004, except for those VIEs that are considered to be special-purpose entities, for which the effective date is no later that the end of the first reporting period that ends after December 31, 2003. The adoption of FIN No. 46 and the Revised Interpretations has not and is not expected to have an impact on our consolidated financial statements.

In December 2003, the Securities and Exchange Commission (the SEC) issued Staff Accounting Bulletin (SAB) No. 104, *Revenue Recognition* (SAB No. 104), which codifies, revises and rescinds certain sections of SAB No. 101, Revenue Recognition, in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB No. 104 did not have a material effect on our consolidated results of operations, consolidated financial position or consolidated cash flows.

In May 2003, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS No. 150 establishes standards for the classification and measurement of certain instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS No. 150 requires the classification of any financial instruments with a mandatory redemption feature, an obligation to repurchase equity shares, or a conditional obligation based on the issuance of a variable number of its equity shares, as a liability. The adoption of SFAS No. 150 did not have a material effect on our consolidated financial statements.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, effective for contracts entered into or modified after June 30, 2003. This amendment clarifies when a contract meets the characteristics of a derivative, clarifies when a derivative contains a financing component, and amends certain other existing pronouncements. The adoption of SFAS No. 149 did not have a material effect on our consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45 (FIN No. 45), *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, which addresses the disclosure to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees. The disclosure requirements are effective for interim and annual financial statements ending after December 15, 2002. The Company does not have any material guarantees that require disclosure under FIN No. 45.

Table of Contents

FIN No. 45 also requires the recognition of a liability by a guarantor at the inception of certain guarantees. FIN No. 45 requires the guarantor to recognize a liability for the non-contingent component of a guarantee, which is the obligation to stand ready to perform in the event that specified triggering events or conditions occur. The initial measurement of this liability is the fair value of the guarantee at inception. The recognition of the liability is required even if it is not probable that payments will be required under the guarantee or if the guarantee was issued with a premium payment or as part of a transaction with multiple elements. The initial recognition and measurement provisions are effective for all guarantees within the scope of FIN No. 45 issued or modified after December 28, 2002.

As noted above the Company has adopted the disclosure requirements of FIN No. 45 and will apply the recognition and measurement provisions for all guarantees entered into or modified after December 31, 2002. For the year ended December 31, 2003, the Company has not entered into any guarantees within the scope of FIN No. 45.

Forward-Looking Statements

This document includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to, among other things, our financial condition, our results of operations, our growth strategy and the business of our company generally. In some cases, you can identify such statements by terminology such as may, will, should, expects, plans, anticipates, believes, intends or other such terminology. These forward-looking statements involve risks, uncertainties and other factors that may cause our actual results in future periods to differ materially from forecasted results. These risks and uncertainties include, without limitation, the risk factors set forth below and elsewhere in this report and other risks and uncertainties more fully described in our other filings with the Securities and Exchange Commission. We caution that the risk factors set forth in this report are not exclusive. We disclaim any obligation to revise or update any forward-looking statement that may be made from time to time by us or on our behalf.

Risk Factors That May Affect Future Results and Market Price of Our Common Stock

Set forth below and elsewhere in this report and in other documents we file with the Securities and Exchange Commission are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this report.

Risks Related to Our Business

We are highly leveraged, future cash flows may not be sufficient to meet our obligations and we might have difficulty obtaining more financing.

We have a substantial amount of debt. As of December 28, 2003, the aggregate principal amount of our outstanding indebtedness was approximately \$99.7 million. Our highly leveraged financial position means:

a substantial portion of our cash flow from operations will be required to service our indebtedness;

our ability to obtain financing in the future for working capital, capital expenditures and general corporate purposes might be impeded; and

we are more vulnerable to economic downturns and our ability to withstand competitive pressures is limited.

If our business declines, our future cash flow might not be sufficient to meet our obligations and commitments.

If we fail to make any required payment under our credit facility or indenture, our debt may be accelerated under these instruments. In addition, in the event of bankruptcy or insolvency or a material breach of any covenant contained in one of our debt instruments, our debt may be accelerated. This acceleration could also result in the acceleration of other indebtedness that we may have outstanding at that time.

Table of Contents

If we are unable to generate sufficient cash flow from operations to meet our obligations and commitments, we will be required to refinance or restructure our indebtedness or raise additional debt or equity capital. Additionally, we may be required to sell material assets or operations or delay or forego expansion opportunities. These alternative strategies might not be effected on satisfactory terms, if at all.

The terms of our debt instruments impose operating and financial restrictions on us, which may impair our ability to respond to changing business and economic conditions.

The terms of our debt instruments impose operating and financial restrictions on us, including, among other things, restrictions on our ability to incur additional indebtedness, create or allow liens, pay dividends, engage in mergers, acquisitions or reorganizations or make specified capital expenditures. For example, our ability to engage in the foregoing transactions will depend upon, among other things, our level of indebtedness at the time of the proposed transaction and whether we are in default under our financing agreements. As a result, our ability to respond to changing business and economic conditions and to secure additional financing, if needed, may be significantly restricted, and we may be prevented from engaging in transactions that might further our growth strategy or otherwise benefit us without obtaining consent from our lenders. In addition, our credit facility is secured by a first priority security interest in our trade accounts receivable, merchandise inventories, service marks and trademarks and other general intangible assets, including trade names. In the event of our insolvency, liquidation, dissolution or reorganization, the lenders under our debt instruments would be entitled to payment in full from our assets before distributions, if any, were made to our stockholders.

If we are unable to successfully implement our controlled growth strategy or manage our growing business, our future operating results could suffer.

One of our strategies includes opening profitable stores in new and existing markets. Our ability to successfully implement our growth strategy could be negatively affected by any of the following:

suitable sites may not be available for leasing;

we may not be able to negotiate acceptable lease terms;

we might not be able to hire and retain qualified store personnel; and

we might not have the financial resources necessary to fund our expansion plans.

In addition, our expansion in new and existing markets may present competitive, distribution and merchandising challenges that differ from our current challenges. These potential new challenges include competition among our stores, added strain on our distribution center, additional information to be processed by our management information systems and diversion of management attention from ongoing operations. We face additional challenges in entering new markets, including consumers' lack of awareness of us, difficulties in hiring personnel and problems due to our unfamiliarity with local real estate markets and demographics. New markets may also have different competitive conditions, consumer tastes and discretionary spending patterns than our existing markets. To the extent that we are not able to meet these new challenges, our net sales could decrease and our operating costs could increase.

Because our stores are concentrated in the western United States, we are subject to regional risks.

Our stores are located in the western United States. Because of this, we are subject to regional risks, such as the economy, weather conditions, power outages, electricity costs and earthquakes and other natural disasters specific to the states in which we operate. For example, particularly in southern California where we have a high concentration of stores, seasonal factors such as unfavorable snow conditions, such as those that occurred in the winter of 2002-2003, inclement weather or other localized conditions such as flooding, fires (such as the major fires in 2003), earthquakes or electricity blackouts could harm our operations. State and local regulatory compliance, such as the recent rise in California's workers compensation costs, also can impact our financial results. If the region were to suffer an economic downturn or other adverse regional event, our net sales and profitability and our ability to implement our planned expansion program could suffer.

Table of Contents

Several of our competitors operate stores across the United States and thus are not as vulnerable to these regional risks.

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

Our future success depends to a significant degree on the skills, experience and efforts of Steven G. Miller, our Chairman, President and Chief Executive Officer, and other key personnel who are not obligated to stay with us. The loss of the services of any of these individuals could harm our business and operations. In addition, as our business grows, we will need to attract and retain additional qualified personnel in a timely manner and develop, train and manage an increasing number of management level sales associates and other employees. Competition for qualified employees could require us to pay higher wages and benefits to attract a sufficient number of employees, and increases in the federal minimum wage or other employee benefits costs could increase our operating expenses. If we are unable to attract and retain personnel as needed in the future, our net sales growth and operating results may suffer.

Our hardware and software systems are vulnerable to damage that could harm our business.

Our success, in particular our ability to successfully manage inventory levels, largely depends upon the efficient operation of our computer hardware and software systems. We use management information systems to track inventory information at the store level, communicate customer information and aggregate daily sales information. These systems and our operations are vulnerable to damage or interruption from:

earthquake, fire, flood and other natural disasters;

power loss, computer systems failures, internet and telecommunications or data network failure, operator negligence, improper operation by or supervision of employees, physical and electronic loss of data or security breaches, misappropriation and similar events; and

computer viruses.

Any failure that causes an interruption in our operations or a decrease in inventory tracking could result in reduced net sales and profitability.

If our suppliers do not provide sufficient quantities of products, our net sales and profitability could suffer.

We purchase merchandise from over 750 vendors. Although we did not rely on any single vendor for more than 6.1% of our total purchases during the fiscal year ended December 28, 2003, our dependence on principal suppliers involves risk. Our 20 largest vendors collectively accounted for 36.2% of our total purchases during the fiscal year ended December 28, 2003. If there is a disruption in supply from a principal supplier or distributor, we may be unable to obtain merchandise that we desire to sell and that consumers desire to purchase. In addition, a significant portion of the products that we purchase, including those purchased from domestic suppliers, are manufactured abroad. A vendor could discontinue selling products to us at any time for reasons that may or may not be in our control. Our net sales and profitability could decline if we are unable to promptly replace a vendor who is unwilling or unable to satisfy our requirements with a vendor providing equally appealing products.

Because all of our stores rely on a single distribution center, any disruption could reduce our net sales.

We currently rely on a single distribution center in Fontana, California. Any natural disaster or other serious disruption to this distribution center due to fire, earthquake or any other cause could damage a significant portion of our inventory and could materially impair both our ability to adequately stock our stores and our net sales and profitability. If the security measures used at our distribution center do not prevent inventory theft, our gross margin may significantly decrease. In August 2002, we entered into a two-year lease for an additional 136,000 square foot satellite distribution center to handle seasonal merchandise and returns. We recently extended the lease on the satellite distribution center until the end of February 2005. In addition,

Table of Contents

because of limited capacity at the current distribution center, we will need to build a replacement distribution center in the next 12 to 24 months. Any disruption to, or delay in, this process could harm our future operations.

Because equity owners of a significant stockholder of one of our competitors serve on our board of directors and the board of directors of such competitor, there may be conflicts of interest.

Green Equity Investors, L.P., an affiliate of Leonard Green & Partners, L.P., holds approximately 7.8% of the outstanding common stock of The Sports Authority, Inc., one of our competitors. John G. Danhaki, an equity owner of Leonard Green & Partners, L.P., currently serves on our board of directors. Jonathan D. Sokoloff, an equity owner of Leonard Green & Partners, L.P. and a former member of our board of directors, currently serves on The Sports Authority, Inc.'s board of directors. Mr. Danhaki may have conflicts of interest with respect to certain matters affecting us, including the pursuit of certain business opportunities presented to Leonard Green & Partners, L.P. All potential conflicts may not be resolved in a manner that is favorable to us. We believe it is impossible to predict the precise circumstances under which future potential conflicts may arise and therefore intend to address potential conflicts on a case-by-case basis. Under Delaware law, directors have a fiduciary duty to act in good faith and in what they believe to be in the best interest of the corporation and its stockholders. Such duties include the duty to refrain from impermissible self-dealing and to deal fairly with respect to transactions in which the directors, or other companies with which such directors are affiliated, have an interest.

Recently enacted and proposed changes in securities laws and regulations are likely to increase our costs.

The Sarbanes-Oxley Act of 2002 (the Act) that became law in July 2002, as well as new rules and regulations subsequently implemented by the Securities and Exchange Commission (the SEC), have required and will require changes in some of our corporate governance practices. The Act also requires the SEC to promulgate additional new rules on a variety of subjects. In addition to final rules and rule proposals already made by the SEC, Nasdaq has proposed revisions to its requirements for companies that are quoted on The Nasdaq Stock Market, Inc.'s National Market. We expect these new rules and regulations to increase our legal and financial compliance costs and to make some activities more difficult, time consuming and/or costly. We also expect these new rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These new rules and regulations could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee, and qualified executive officers.

Risks Related to Our Industry

A downturn in the economy may affect consumer purchases of discretionary items, which could reduce our net sales.

In general, our sales represent discretionary spending by our customers. Discretionary spending is affected by many factors, including, among others, general business conditions, interest rates, inflation, consumer debt levels, the availability of consumer credit, taxation, electricity power rates, unemployment trends and other matters that influence consumer confidence and spending. Our customers' purchases of discretionary items, including our products, could decline during periods when disposable income is lower or periods of actual or perceived unfavorable economic conditions. If this occurs, our net sales and profitability could decline.

Seasonal fluctuations in the sales of sporting goods could cause our annual operating results to suffer significantly.

We experience seasonal fluctuations in our net sales and operating results. In fiscal 2003, we generated 27.0% of our net sales and 35.2% of our operating income in the fourth fiscal quarter, which includes the holiday selling season as well as the peak winter sports selling season. As a result, we incur significant additional expenses in the fourth fiscal quarter due to higher purchase volumes and increased staffing. If we

Table of Contents

miscalculate the demand for our products generally or for our product mix during the fourth fiscal quarter, our net sales could decline, resulting in excess inventory, which could harm our financial performance. Because a substantial portion of our operating income is derived from our fourth fiscal quarter net sales, a shortfall in expected fourth fiscal quarter net sales could cause our annual operating results to suffer significantly.

Intense competition in the sporting goods industry could limit our growth and reduce our profitability.

The retail market for sporting goods is highly fragmented and intensely competitive. We compete directly or indirectly with the following categories of companies:

other traditional sporting goods stores and chains;

mass merchandisers, discount stores and department stores, such as Wal-Mart, Kmart, Target, Kohls, JC Penney, and Sears;

specialty sporting goods shops and pro shops, such as The Athletes Foot and Foot Locker;

sporting goods superstores, such as The Sports Authority, Inc., and its other operating units, Oshmans, Sportmart and Gart Sports Company; and

internet retailers.

Some of our competitors have a larger number of stores and greater financial, distribution, marketing and other resources than we have. Two of our major competitors, The Sports Authority, Inc. and Gart Sports Company (including its other operating units, Oshmans and Sportmart), completed a merger in August 2003 and now operate under the name The Sports Authority, Inc. In addition, if our competitors reduce their prices, it may be difficult for us to reach our net sales goals without reducing our prices. As a result of this competition, we may also need to spend more on advertising and promotion than we anticipate. If we are unable to compete successfully, our operating results will suffer.

We may incur costs from litigation or increased regulation relating to products that we sell, particularly firearms.

We sell products manufactured by third parties, some of which may be defective. If any product that we sell were to cause physical injury or injury to property, the injured party or parties could bring claims against us as the retailer of the product. Our insurance coverage may not be adequate to cover every claim that could be asserted against us. If a successful claim were brought against us in excess of our insurance coverage, it could harm our business. Even unsuccessful claims could result in the expenditure of funds and management time and could have a negative impact on our business. In addition, our products are subject to the Federal Consumer Product Safety Act, which empowers the Consumer Product Safety Commission to protect consumers from hazardous sporting goods and other articles. The Consumer Product Safety Commission has the authority to exclude from the market certain consumer products that are found to be hazardous. Similar laws exist in some states and cities in the United States. If we fail to comply with government and industry safety standards, we may be subject to claims, lawsuits, fines and negative publicity that could harm our operating results.

In addition, we sell firearms and ammunition, products associated with an increased risk of injury and related lawsuits. Sales of firearms and ammunition have historically represented less than 5% of our annual net sales. We may incur losses due to lawsuits relating to our performance of background checks on firearms purchases as mandated by state and federal law or the improper use of firearms sold by us, including lawsuits by municipalities or other organizations attempting to recover costs from firearms manufacturers and retailers relating to the misuse of firearms. In addition, in the future there may be increased federal, state or local regulation, including taxation, of the sale of firearms in both our current markets as well as future markets in which we may operate. Commencement of these lawsuits against us or the establishment of new regulations could reduce our net sales and decrease our profitability.

Table of Contents

If we fail to anticipate changes in consumer preferences, we may experience lower net sales, higher inventory markdowns and lower margins.

Our products must appeal to a broad range of consumers whose preferences cannot be predicted with certainty. These preferences are also subject to change. Our success depends upon our ability to anticipate and respond in a timely manner to trends in sporting goods merchandise and consumers' participation in sports. If we fail to identify and respond to these changes, our net sales may decline. In addition, because we often make commitments to purchase products from our vendors up to six months in advance of the proposed delivery, if we misjudge the market for our merchandise, we may over-stock unpopular products and be forced to take inventory markdowns that could have a negative impact on profitability.

Terrorism and the uncertainty of war may harm our operating results.

Terrorist attacks or acts of war may cause damage or disruption to us and our employees, facilities, information systems, vendors, and customers, which could significantly impact our net sales, costs and expenses and financial condition. The threat of terrorist attacks since September 11, 2001 continues to create many economic and political uncertainties. The potential for future terrorist attacks, the national and international responses to terrorist attacks and other acts of war or hostility may cause greater uncertainty and cause our business to suffer in ways that we currently cannot predict. Military action taken by the United States and its allies in Iraq or elsewhere could have a short or long term negative economic impact upon the financial markets and our business in general.

Risks Related to Investing in Our Common Stock

The price of our common stock may be volatile.

The trading price of our common stock may fluctuate widely as a result of a number of factors, many of which are outside our control. In addition, the stock market has experienced extreme price and volume fluctuations that have affected the market prices of many companies. These broad market fluctuations could adversely affect the market price of our common stock. A significant decline in our stock price could result in substantial losses for individual stockholders and could lead to costly and disruptive securities litigation.

Substantial amounts of our common stock could be sold in the near future, which could depress our stock price.

We cannot predict the effect, if any, that the availability of shares of common stock for sale will have on the market price of our common stock prevailing from time to time. At March 5, 2004, there were 22,664,627 shares of our common stock outstanding. All of these shares are freely transferable without restriction or further registration under the federal securities laws, except for any shares held by our affiliates, sales of which will be limited by Rule 144 under the Securities Act of 1933. Sales of a significant number of these shares of common stock in the public market could reduce the market price of the common stock or our ability to raise capital by offering equity securities.

Our anti-takeover provisions could prevent or delay a change in control of our company, even if such change of control would be beneficial to our stockholders.

Provisions of our amended and restated certificate of incorporation and amended and restated bylaws as well as provisions of Delaware law could discourage, delay or prevent a merger, acquisition or other change in control of our company, even if such change in control would be beneficial to our stockholders. These provisions include:

a board of directors that is classified such that only one-third of directors are elected each year;

authorization of the issuance of blank check preferred stock that could be issued by our board of directors to increase the number of outstanding shares and thwart a takeover attempt;

limitations on the ability of stockholders to call special meetings of stockholders;

Table of Contents

prohibition of stockholder action by written consent and requiring all stockholder actions to be taken at a meeting of our stockholders; and

establishment of advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings.

In addition, Section 203 of the Delaware General Corporations Law limits business combination transactions with 15% stockholders that have not been approved by the board of directors. These provisions and other similar provisions make it more difficult for a third party to acquire us without negotiation. These provisions may apply even if the transaction may be considered beneficial by some stockholders.

Table of Contents

PART IV

Item 15: Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(A) Documents filed as part of this report:

(1) Financial Statements.

See Index to Consolidated Financial Statements on page F-1 hereof.

(2) Financial Statement Schedule.

See Index to Consolidated Financial Statements Index on page F-1 hereof.

(3) Exhibits and Reports on Form 8-K.

(a) Exhibits

- 3.1 Amended and Restated Certificate of Incorporation of Big 5 Sporting Goods Corporation.(7)
- 3.2 Amended and Restated Bylaws.(7)
- 4.1 Specimen of Common Stock Certificate.(5)
- 4.2 Indenture dated as of November 13, 1997 between Big 5 Corp. and First Trust National Association, as trustee.(1)
- 4.3 Form of Big 5 Corp. 10.875% Series B Senior Notes due 2007 (included in Exhibit 4.2).(1)
- 4.4 Indenture dated as of November 13, 1997 between Big 5 Sporting Goods Corporation and First Trust National Association, as trustee.(2)
- 4.5 Form of Big 5 Sporting Goods Corporation 13.45% Senior Discount Notes due 2008.(2)
- 10.1 Form of Amended and Restated Stockholders Agreement among Big 5 Sporting Goods Corporation, Green Equity Investors, L.P., Steven G. Miller and Robert W. Miller.(4)
- 10.2 Management Services Agreement dated as of November 13, 1997 by and among Big 5 Sporting Goods Corporation, Big 5 Corp. and Leonard Green & Associates, L.P.(1)
- 10.3 1997 Management Equity Plan.(2)
- 10.4 2002 Stock Incentive Plan.(4)
- 10.5 Form of Amended and Restated Employment Agreement between Robert W. Miller and Big 5 Sporting Goods Corporation.(4)
- 10.6 Form of Amended and Restated Employment Agreement between Steven G. Miller and Big 5 Sporting Goods Corporation(4)
- 10.7 Amended and Restated Indemnification Implementation Agreement between Big 5 Corp. (successor to United Merchandising Corp.) and Thrifty PayLess Holdings, Inc. dated as of April 20, 1994.(7)
- 10.8 Agreement and Release among Pacific Enterprises, Thrifty PayLess Holdings, Inc., Thrifty PayLess, Inc., Thrifty and Big 5 Corp. (successor to United Merchandising Corp.) dated as of March 11, 1994.(7)
- 10.9 Financing Agreement dated March 8, 1996 between The CIT Group/ Business Credit, Inc. and Big 5 Corp.(7)
- 10.10 Grant of Security Interest in and Collateral Assignment of Trademarks and Licenses dated as of March 8, 1996 by Big 5 Corp. in favor of The CIT Group/ Business Credit, Inc.(7)
- 10.11 Guarantee dated March 8, 1996 by Big 5 Corporation (now known as Big 5 Sporting Goods Corporation) in favor of The CIT Group/ Business Credit, Inc.(7)
- 10.12 Letter agreement from The CIT Group/ Business Credit, Inc. to Big 5 Corp. dated November 13, 1997, amending the Financing Agreement dated March 8, 1996 between Big 5 Corp. (successor to United Merchandising Corp.) and The CIT Group/ Business Credit, Inc.(1)
- 10.13 Letter agreement from The CIT Group/ Business Credit, Inc. to Big 5 Corp. dated December 16, 1997, amending the Financing Agreement dated March 8, 1996 between Big 5 Corp. (successor to United Merchandising Corp.) and The CIT Group/ Business Credit, Inc.(2)

Table of Contents

10.14	Fifth Amendment to Financing Agreement, dated March 21, 2000, by and among Big 5 Corp. and The CIT Group/ Business Credit, Inc., amending the Financing Agreement, dated March 8, 1996, between Big 5 Corp. (successor to United Merchandising Corp.) and The CIT Group/ Business Credit, Inc.(2)
10.15	Sixth Amendment to Financing Agreement, dated February 27, 2002, by and among Big 5 Corp. and The CIT Group/ Business Credit, Inc., amending the Financing Agreement, dated March 8, 1996, between Big 5 Corp. (successor to United Merchandising Corp.) and The CIT Group/ Business Credit, Inc.(3)
10.16	Seventh Amendment to Financing Agreement, dated April 30, 2002, by and among Big 5 Corp. and The CIT Group/ Business Credit, Inc., amending the Financing Agreement, dated March 8, 1996, between Big 5 Corp. (successor to United Merchandising Corp.) and The CIT Group/ Business Credit, Inc.(5)
10.17	Form of Indemnification Agreement.(7)
10.18	Form of Termination Agreement by and among Big 5 Sporting Goods Corporation, Big 5 Corp. and Leonard Green & Associates, L.P.(4)
10.19	Stock Subscription Agreement dated as of September 25, 1992, between Big 5 Sporting Goods Corporation and Green Equity Investors, L.P.(4)
10.20	Letter agreement from The CIT Group/ Business Credit, Inc. to Big 5 Corp. dated April 17, 1996, amending the Financing Agreement dated March 8, 1996, between Big 5 Corp. (successor to United Merchandising Corp.) and The CIT Group/ Business Credit, Inc.(4)
10.21	Letter agreement from The CIT Group/ Business Credit, Inc. to Big 5 Corp. dated August 11, 1997, amending the Financing Agreement dated March 8, 1996, between Big 5 Corp. (successor to United Merchandising Corp.) and The CIT Group/ Business Credit, Inc.(4)
10.22	Letter agreement from The CIT Group/ Business Credit, Inc. to Big 5 Corp. dated June 13, 2002, under the Financing Agreement dated March 8, 1996, between Big 5 Corp. (successor to United Merchandising Corp.) and The CIT Group/ Business Credit, Inc.(5)
10.23	Form of Indemnification Letter Agreement.(5)
10.24	Form of Subscription Agreement between Big 5 Sporting Goods Corporation and Green Equity Investors, L.P.(6)
10.25	Form of Subscription Agreement between Big 5 Sporting Goods Corporation and Grand Avenue Associates, L.P.(6)
10.26	Amended and Restated Financing Agreement dated March 20, 2003 between The CIT Group/ Business Credit, Inc., the Lenders and Big 5 Corp.(7)
10.27	Modification and Reaffirmation of Guaranty dated March 20, 2003 by Big 5 Sporting Goods Corporation in favor of The CIT Group/ Business Credit, Inc.(7)
10.28	First Amendment to Financing Agreement dated October 31, 2003, amending the Financing Agreement dated March 20, 2003 between The CIT Group/ Business Credit, Inc., the Lenders and Big 5 Corp.(8)
10.29	Joinder Agreement, dated as of January 28, 2004, by and among Big 5 Corp., Big 5 Services Corp., the Lenders (as defined therein) and The CIT Group/Business Credit, Inc.(8)
10.30	Co-Obligor Agreement, dated as of January 28, 2004, made by Big 5 Corp. and Big 5 Services Corp. in favor The CIT Group/Business Credit, Inc. as agent for the Lenders (as defined therein)(8)
14.1	Code of Business Conduct and Ethics.(8)
21.1	Subsidiaries of Big 5 Sporting Goods Corporation.(2)
23.1	Consent of Independent Registered Public Accounting Firm, KPMG LLP(9)
31.1	Rule 13-a14(a) Certification of Chief Executive Officer.(9)
31.2	Rule 13-a14(a) Certification of Chief Financial Officer.(9)
32.1	Section 1350 Certification of Chief Executive Officer.(9)
32.2	Section 1350 Certification of Chief Financial Officer. (9)

Table of Contents

- (1) Incorporated by reference to Big 5 Corp. s Registration Statement on Form S-4 (File No. 333-43129) filed with the Securities and Exchange Commission on December 23, 1997.
- (2) Incorporated by reference to the Registration Statement on Form S-1 (File No. 333-68094) filed by Big 5 Sporting Goods Corporation on August 21, 2001.
- (3) Incorporated by reference to Amendment No. 1 to the Registration Statement on Form S-1 filed by Big 5 Sporting Goods Corporation on March 18, 2002.
- (4) Incorporated by reference to Amendment No. 2 to the Registration Statement on Form S-1 filed by Big 5 Sporting Goods Corporation on June 5, 2002.
- (5) Incorporated by reference to Amendment No. 4 to the Registration Statement on Form S-1 filed by Big 5 Sporting Goods Corporation on June 24, 2002.
- (6) Incorporated by reference to Amendment No. 5 to the Registration Statement on Form S-1 filed by Big 5 Sporting Goods Corporation on June 25, 2002.
- (7) Incorporated by reference to the Annual Report on Form 10-K filed by Big 5 Sporting Goods Corporation on March 31, 2003.
- (8) Incorporated by reference to the Annual Report on Form 10-K for the fiscal year ended December 28, 2003 filed by Big 5 Sporting Goods Corporation on March 12, 2004.
- (9) Filed herewith.

(b) Reports on Form 8-K

A Form 8-K was furnished October 29, 2003, under Item 12, reporting Big 5 Sporting Goods Corporation s financial results for the fiscal quarter ended September 28, 2003.

A Form 8-K was filed November 17, 2003, under Item 5, reporting that Big 5 Sporting Goods Corporation entered into the Underwriting Agreement dated November 17, 2003 by and among Big 5 Sporting Goods Corporation, Green Equity Investors, L.P. and Credit Suisse First Boston LLC, acting on behalf of itself and as the representative of the several underwriters.

A Form 8-K was filed November 21, 2003, under Item 5, reporting the closing of the public offering on behalf of the selling stockholder, Green Equity Investors, L.P., of 5,200,000 shares of Big 5 Sporting Goods Corporation s common stock.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BIG 5 SPORTING GOODS CORPORATION
a Delaware Corporation

By: */s/ STEVEN G. MILLER*

Steven G. Miller
*Chairman of the Board of Directors,
President, Chief Executive Officer
and Director of the Company*

Date: October 25, 2004

Table of Contents

BIG 5 SPORTING GOODS CORPORATION

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Index to Consolidated Financial Statements	F-1
Management's Responsibility for Financial Statements	F-2
Report of Independent Registered Public Accounting Firm	F-3
Consolidated Balance Sheets at December 29, 2002 and December 28, 2003	F-4
Consolidated Statements of Operations for the fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003	F-5
Consolidated Statements of Stockholders' Equity (Deficit) for the fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003	F-6
Consolidated Statements of Cash Flows for the fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003	F-7
Notes to Consolidated Financial Statements	F-8
	Schedule
Consolidated Financial Statement Schedule: Valuation and Qualifying Accounts as of December 30, 2001, December 29, 2002 and December 28, 2003	II-1

Table of Contents

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

We are responsible for the preparation of our consolidated financial statements and related information appearing in this Annual Report. We believe that the consolidated financial statements fairly reflect the form and substance of transactions and that the financial statements reasonably present our financial position and results of operations in conformity with generally accepted accounting principles. We also have included in our financial statements amounts that are based on estimates and judgments which we believe are reasonable under the circumstances.

The independent auditors audit our consolidated financial statements in accordance with generally accepted auditing standards and provide an objective, independent review of the fairness of reported operating results and financial position.

Our board of directors has a standing audit committee, which is chaired by Sandra N. Bane and currently consists of Ms. Bane, Mr. Danhaki and Ms. Dunbar, each of whom is independent as that term is defined in Marketplace Rule 4200(a)(14) of the National Association of Securities Dealers listing standards. The audit committee meets periodically with financial management and the independent auditors to review accounting, internal control, auditing and financial reporting matters.

/s/ STEVEN G. MILLER

Steven G. Miller
*Chairman of the Board,
President & Chief Executive Officer*

El Segundo, California

March 12, 2004

/s/ CHARLES P. KIRK

Charles P. Kirk
Senior Vice President & Chief Financial Officer

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

Big 5 Sporting Goods Corporation:

We have audited the consolidated financial statements of Big 5 Sporting Goods Corporation and subsidiary as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the consolidated financial statement schedule as listed in the accompanying index. These consolidated financial statements and the consolidated financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the consolidated financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Big 5 Sporting Goods Corporation and subsidiary as of December 29, 2002 and December 28, 2003 and the results of their operations and their cash flows for each of the fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in note 17 to the consolidated financial statements, effective December 31, 2001, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

KPMG LLP

Los Angeles, California
February 11, 2004

F-3

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****CONSOLIDATED BALANCE SHEETS**

	December 29, 2002	December 28, 2003
(Dollars in thousands)		
ASSETS		
Current assets:		
Cash	\$ 9,441	\$ 9,030
Trade and other receivables, net of allowances for doubtful accounts of \$729 and \$520, respectively	9,057	11,522
Merchandise inventories	169,529	179,555
Prepaid expenses	2,385	5,017
	<u> </u>	<u> </u>
Total current assets	190,412	205,124
	<u> </u>	<u> </u>
Property and equipment:		
Land	186	186
Buildings and improvements	36,861	38,666
Furniture and equipment	55,930	64,341
Less accumulated depreciation and amortization	(47,873)	(56,241)
	<u> </u>	<u> </u>
Net property and equipment	45,104	46,952
Deferred income taxes, net	9,658	9,628
Leasehold interest, net of accumulated amortization of \$23,053 and \$28,842, respectively	5,811	4,022
Other assets, at cost, less accumulated amortization of \$4,974 and \$2,281, respectively	2,557	1,865
Goodwill	4,433	4,433
	<u> </u>	<u> </u>
Total assets	\$257,975	\$272,025
	<u> </u>	<u> </u>
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 67,937	\$ 76,004
Accrued expenses	49,708	54,717
	<u> </u>	<u> </u>
Total current liabilities	117,645	130,721
Deferred rent	11,525	11,654
Long-term debt	125,131	99,686
	<u> </u>	<u> </u>
Total liabilities	254,301	242,061
	<u> </u>	<u> </u>
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$.01 par value. Authorized 50,000,000 shares; issued and outstanding 22,178,018 shares at December 29, 2002 and 22,663,927 shares at December 28, 2003	222	227
Additional paid-in capital	84,008	84,003
Accumulated deficit	(80,556)	(54,266)
	<u> </u>	<u> </u>
Net stockholders' equity	3,674	29,964

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Total liabilities and Stockholders' equity	<u>\$257,975</u>	<u>\$272,025</u>
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See accompanying notes to consolidated financial statements.

F-4

Table of Contents

BIG 5 SPORTING GOODS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year ended December 30, 2001	Year ended December 29, 2002	Year ended December 28, 2003
(Dollars and shares in thousands, except per share data)			
Net sales	\$622,481	\$667,469	\$709,740
Cost of goods sold, buying and occupancy, excluding depreciation and amortization shown separately below	407,679	429,858	453,814
Gross profit	214,802	237,611	255,926
Operating expenses:			
Selling and administrative	160,044	174,868	186,798
Litigation settlement (note 11)	2,515		
Depreciation and amortization	10,031	9,966	10,412
Total operating expenses	172,590	184,834	197,210
Operating income	42,212	52,777	58,716
Premium (discount) and unamortized financing fees related to redemption of debt	(2,662)	4,557	3,434
Interest expense, net	19,629	15,825	11,405
Income before income taxes	25,245	32,395	43,877
Income taxes	10,280	13,313	17,587
Net income	14,965	19,082	26,290
Redeemable preferred stock dividends and redemption premium	7,284	7,999	
Net income available to common stockholders	\$ 7,681	\$ 11,083	\$ 26,290
Earnings per share:			
Basic	\$ 0.54	\$ 0.60	\$ 1.16
Diluted	\$ 0.48	\$ 0.57	\$ 1.16
Weighted average shares of common stock outstanding:			
Basic	14,247	18,358	22,651
Diluted	16,090	19,476	22,753

See accompanying notes to consolidated financial statements.

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)****YEARS ENDED DECEMBER 30, 2001, DECEMBER 29, 2002 AND DECEMBER 28, 2003**

	Common Stock		Additional paid-in capital	Accumulated Deficit	Net Stockholders Equity (Deficit)
	Shares	Amount			
	(Dollars in thousands)				
Balance at December 31, 2000	15,604,650	\$ 156	\$ 7,059	\$ (99,320)	\$ (92,105)
Redeemable preferred stock dividend				(7,284)	(7,284)
Repurchase of common stock	(2,430)		(1)		(1)
Net income				14,965	14,965
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance at December 30, 2001	15,602,220	156	7,058	(91,639)	(84,425)
Redeemable preferred stock dividend and redemption premiums				(7,999)	(7,999)
Issuance of common stock	7,112,421	71	86,243		86,314
Repurchase of common stock	(536,623)	(5)	(6,951)		(6,956)
Stock issuance costs			(2,342)		(2,342)
Net income				19,082	19,082
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance at December 29, 2002	22,178,018	222	84,008	(80,556)	3,674
Net income				26,290	26,290
Exercise of warrant	485,909	5	(5)		
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balance at December 28, 2003	<u>22,663,927</u>	<u>\$ 227</u>	<u>\$ 84,003</u>	<u>\$ (54,266)</u>	<u>\$ 29,964</u>

See accompanying notes to consolidated financial statements.

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Year ended December 30, 2001	Year ended December 29, 2002	Year ended December 28, 2003
(Dollars in thousands)			
Cash flows from operating activities:			
Net income	\$ 14,965	\$ 19,082	\$ 26,290
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	10,031	9,966	10,412
Amortization of deferred finance charges and discounts	3,932	2,291	594
Deferred tax provision (benefit)	806	4,050	30
Loss on disposal of equipment and leasehold interest	43	6	140
Premium (discount) and unamortized financing fees related to redemption of debt	(2,662)	4,557	3,434
Changes in assets and liabilities:			
Merchandise inventories	5,301	(5,849)	(10,026)
Trade and other accounts receivable, net	(800)	(828)	(2,465)
Prepaid expenses and other assets	(959)	(566)	(3,446)
Accounts payable	(4,204)	1,330	2,708
Accrued expenses	5,068	(1,924)	5,008
Net cash provided by operating activities	<u>31,521</u>	<u>32,115</u>	<u>32,679</u>
Cash flows from investing activities			
purchases of property and equipment	(10,510)	(10,207)	(10,482)
Cash flows from financing activities:			
Net borrowings (repayments) under revolving credit facilities, and other	(10,210)	1,579	34,735
Issuance of common stock		86,314	
Stock issuance costs		(2,342)	
Repayment of senior discount notes and 10.875% senior notes	(6,688)	(31,006)	(57,343)
Redemption of preferred stock		(67,921)	
Repurchase of common stock	(1)	(6,956)	
Net cash used in financing activities	<u>(16,899)</u>	<u>(20,332)</u>	<u>(22,608)</u>
Net increase (decrease) in cash	4,112	1,576	(411)
Cash at beginning of year	<u>3,753</u>	<u>7,865</u>	<u>9,441</u>
Cash at end of year	<u>\$ 7,865</u>	<u>\$ 9,441</u>	<u>\$ 9,030</u>
Supplemental disclosures of non-cash financing activities:			
Accreted dividends on preferred stock	\$ 7,284	\$ 3,529	\$
Supplemental disclosures of cash flow information:			
Interest paid	\$ 14,690	\$ 13,066	\$ 11,505
Income taxes paid	13,820	11,850	14,908

See accompanying notes to consolidated financial statements.

F-7

Table of Contents

BIG 5 SPORTING GOODS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 29, 2002 and December 28, 2003

(Dollars in thousands)

(1) Basis of Presentation and Description of Business

The accompanying consolidated financial statements as of December 29, 2002 and December 28, 2003 and for the years ended December 30, 2001, December 29, 2002 and December 28, 2003 represent the financial position and results of operations of Big 5 Sporting Goods Corporation and its wholly owned subsidiary, Big 5 Corp. The Company operates in one business segment, as a sporting goods retailer under the Big 5 Sporting Goods name carrying a broad range of hardlines, softlines and footwear, operating 293 stores at December 28, 2003 in California, Washington, Arizona, Oregon, Texas, New Mexico, Nevada, Utah, Idaho and Colorado.

(2) Initial Public Offering

In the second quarter of 2002, the Company completed an initial public offering of 8.1 million shares of common stock, of which 1.6 million shares were sold by selling stockholders. In the third quarter of 2002, the Company's underwriters exercised their right to purchase an additional 1.2 million shares through their over-allotment option, of which 0.5 million shares were sold by selling stockholders. With net proceeds of \$76.1 million from the offering and total net proceeds of \$84.0 million after exercise of the underwriters' over-allotment option, and together with borrowings under its credit facility, the Company redeemed all of its outstanding senior discount notes for \$27.5 million and preferred stock for \$67.9 million, paid bonuses to executive officers and directors of \$2.0 million which were funded by a reduction in the redemption price of the Company's preferred stock and repurchased 0.5 million shares of the Company's common stock from non-executive employees for \$6.9 million. All uses of proceeds, other than the payment of a portion of the bonuses related to the initial public offering and certain initial public offering costs, occurred in the third quarter of fiscal 2002.

(3) Summary of Significant Accounting Policies
Consolidation

The consolidated financial statements include Big 5 Sporting Goods Corporation and Big 5 Corp. All significant intercompany balances and transactions have been eliminated in consolidation.

Reporting Period

The Company reports on the 52-53 week fiscal year ending on the Sunday nearest December 31. Information presented for the years ended December 30, 2001, December 29, 2002 and December 28, 2003 represents 52-week fiscal years.

Revenue Recognition

The Company's revenue is received from retail sales of merchandise through the Company's stores. Revenue is recognized when merchandise is received by the customer and is shown net of actual returns during the relevant period. Actual returns were \$38.4 million, \$50.5 million and \$52.6 million for the fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003, respectively. The Company does not maintain a sales return allowance. The difference between recording actual sales returns and establishing an allowance for sales returns is not considered to have a material impact on the Company's financial statements for the periods presented.

Trade and Other Receivables

Trade accounts receivable consist primarily of third party credit card receivables. Other receivables consist principally of net amounts due from vendors for certain co-op advertising. Accounts receivable have

Table of Contents

BIG 5 SPORTING GOODS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

not historically resulted in any material credit losses. An allowance for doubtful accounts is provided when accounts are determined to be uncollectible.

Merchandise Inventories

The Company values merchandise inventories using the lower of weighted average cost (which approximates the first-in, first-out cost) or market method. Average cost includes the direct purchase price of merchandise inventory and overhead costs associated with the Company's distribution center.

Property and Equipment

Property and equipment are stated at cost and depreciated over the estimated useful lives or lease terms, using the straight-line method.

The estimated useful lives are 40 years for buildings, 7 to 10 years for fixtures and equipment and the shorter of the lease term or 10 years for leasehold improvements. Maintenance and repairs are charged to expense as incurred.

Leasehold Interest

Upon acquisition of the Company by management and others in 1992, an asset was recognized for the net fair value of favorable operating lease agreements. The leasehold interest asset is being amortized on a straight-line basis over 13.5 years. The unamortized balance attributable to leases terminated subsequent to the acquisition has been reflected as a component of the gain or loss upon disposition of the underlying properties.

Goodwill

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, was historically amortized on a straight-line basis over periods ranging from 15 to 30 years. In fiscal 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, which requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually. Upon adoption of SFAS No. 142, the Company was required to evaluate its existing goodwill for impairment. To accomplish this, the Company was required to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of December 31, 2001. The Company has determined that it has one reporting unit under SFAS No. 142. The Company was then required to determine the fair value of the reporting unit and compare it to the carrying amount of the reporting unit within six months of December 31, 2001 to determine if further impairment analysis was required. The results of this analysis did not require the Company to recognize an impairment loss upon adoption or upon the annual impairment test. Prior to the adoption of SFAS No. 142, the amount of goodwill and other intangible asset impairment, if any, was measured based upon projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds. The Company performed its annual impairment test as of December 28, 2003, and goodwill was not considered impaired.

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

The Company reviews its long-lived assets and certain identifiable intangibles 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 measured 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 to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the

Table of Contents

BIG 5 SPORTING GOODS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.

Other Assets

Other assets consist principally of deferred financing costs and are amortized straight-line over the terms of the respective debt, which approximates the effective interest method.

Self-Insurance Reserves

The Company maintains self-insurance programs for workers' compensation and general liability risks. The Company is self-insured up to specified per-occurrence limits and maintains insurance coverage for losses in excess of specified amounts. Estimated costs under these programs, including incurred but not reported claims, are recorded as expenses based upon actuarially determined historical experience and trends of paid and incurred claims. Self-insurance reserves amount to \$5.9 million and \$6.5 million at December 29, 2002 and December 28, 2003, respectively, and are included in accrued liabilities.

Preopening Expenses

New store preopening expenses are charged against operations as incurred.

Advertising Expenses

The Company expenses advertising costs the first time the advertising takes place. Advertising expenses amounted to \$36.0 million for the year ended December 30, 2001, \$37.0 million for the year ended December 29, 2002, and \$39.9 million for the year ended December 28, 2003. Advertising expense is included in selling and administrative expenses in the accompanying statements of operations. There are no amounts related to advertising reported as assets in the balance sheets presented. The Company receives cooperative advertising allowances from manufacturers in order to subsidize qualifying advertising and similar promotional expenditures made relating to vendors' products. These advertising allowances are recognized as a reduction to selling and administrative expense when the Company incurs the advertising eligible for the credit. The Company recognized cooperative advertising allowances of \$5.4 million, \$6.0 million, and \$6.3 million for the fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003, respectively.

Rent Expense

The Company leases the majority of store locations under operating leases that provide for annual payments that increase over the life of the leases. The aggregate of the minimum annual payments are expensed on a straight-line basis over the term of the related lease. The amount by which straight-line rent expense exceeds actual lease payment requirements in the early years of the leases is accrued as deferred rent liability and reduced in later years when the actual cash payment requirements exceed the straight-line expense.

Income Taxes

The Company accounts for income taxes under the asset and liability method whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

realizability of deferred tax assets is assessed throughout the year and a valuation allowance is recorded if necessary to reduce net deferred tax assets to an amount whose realization is more likely than not.

Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from these estimates.

Stock Compensation

The Company measures compensation costs under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and complies with the pro forma disclosure requirements of SFAS No. 123, except for options and warrants granted to non-employees, which are recorded in the financial statements under the fair value method.

SFAS Statement No. 123, *Accounting for Stock-Based Compensation*, and SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure, an amendment to FASB Statement No. 123*, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based compensation plans. As permitted by existing accounting standards, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123, as amended. The following table illustrates the effect on net income if the fair-value-based method had been applied to all outstanding and unvested awards in each period.

Had the Company determined compensation cost based upon the fair value at the grant date for its stock options and restricted stock using the Black Scholes option pricing model, pro forma net income and pro forma net income per share, including the following weighted average assumptions used in these calculations, would have been as follows:

	Fiscal Year Ending		
	December 30, 2001	December 29, 2002	December 28, 2003
Net income, as reported	\$ 14,965	\$ 19,082	\$ 26,290
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	323	310	293
Pro forma net income	\$ 14,642	\$ 18,772	\$ 25,997
Earnings per share:			
Basic as reported	0.54	\$ 0.60	\$ 1.16
Basic pro forma	0.52	\$ 0.59	\$ 1.15
Diluted as reported	0.48	\$ 0.57	\$ 1.16
Diluted pro forma	0.46	\$ 0.55	\$ 1.14
Risk free interest rate	3.6%	3.6%	5.5%
Expected lives	4 years	4 years	4 years
Expected volatility	60%	60%	60%
Expected dividends			

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Earnings Per Share**

Basic earnings per share is calculated by dividing net income available to common stockholder by the weighted average common shares outstanding during the period excluding unvested restricted shares issued under the 1997 Management Equity Plan (1997 Plan) (see note 15). Diluted earnings per share is calculated by using the weighted average of common shares outstanding adjusted to include the potentially dilutive effect of an outstanding warrant, outstanding stock options and the dilutive effect of unvested restricted shares issued under the 1997 Plan (see note 16). The warrant was exercised in the first quarter of 2003 (see note 15).

Repurchase of Debt

In January 2003, we adopted the provisions of SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*. SFAS No. 145 provides that the gain or loss recognized upon early debt extinguishment may no longer be classified as extraordinary, but rather must be recognized as a component of net income before extraordinary items, unless the debt extinguishment meets certain criteria set forth in the APB Opinion No. 30, *Reporting the Results of Operations: Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB No. 30). These criteria, which include that the debt extinguishment be unusual in nature and occur infrequently, are expected to be satisfied infrequently. SFAS No. 145 requires enterprises to reclassify prior period items that do not meet the extraordinary item classification criteria in APB No. 30 upon adoption. Upon adoption of SFAS No. 145, the Company has retroactively reclassified extraordinary gains and losses related to the redemption of debt for all prior periods presented.

(4) Long-Term Debt

Long-term debt consists of the following:

	December 29, 2002	December 28, 2003
Revolving credit facility	\$ 22,280	\$ 51,656
10.875% senior notes due 2007, net of unamortized discount, \$48.1 million face amount at December 28, 2003	102,851	48,030
Total long-term debt	\$ 125,131	\$ 99,686

In 1997, the Company issued \$131.0 million face amount, 10.875% senior notes due 2007, less a discount of \$0.6 million based on an imputed interest rate of 10.95%. The 10.875% senior notes require semiannual interest payments on each May 15 and November 15, commencing on May 15, 1998. The Company has no mandatory payments of principal on the 10.875% senior notes prior to their maturity in 2007. The 10.875% senior notes may be redeemed in whole or in part, at the option of the Company, at any time on or after November 15, 2002, at the redemption prices set forth below with respect to the indicated redemption date, together with any accrued and unpaid interest to such redemption date. The 10.875% senior notes are unsecured obligations that rank senior in right of payment to all existing and future indebtedness that is subordinated to the 10.875% senior notes and rank *pari passu* in right of payment with all current and future unsubordinated indebtedness, subject to restrictions due to the securitization of certain assets. During the fiscal year ended December 29, 2002, the Company repurchased \$1.0 million face value of 10.875% senior notes for a repurchase price of \$1.0 million. During the fiscal year ended December 28, 2003, the Company repurchased an additional \$55.0 million face value for a repurchase price of \$58.0 million.

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

If redeemed during the 12-month period beginning November 15 the redemption prices of the 10.875% senior notes before accrued and unpaid interest are as follows:

Year	Percentage
2003	103.650%
2004	101.825
2005 and thereafter	100.000

In 1997, the Company issued \$48.2 million face amount 13.45% senior discount notes due 2008, less a discount of \$24.0 million based on an imputed interest rate of 13.85%. The senior discount notes were issued with a warrant (see note 15) for aggregate consideration of \$24.5 million. The senior discount notes were unsecured and cash interest did not accrue on the senior discount notes prior to November 30, 2002. The Company had no mandatory payments of principal on the senior discount notes prior to their maturity in 2008. The senior discount notes could be redeemed in their entirety only, at the option of the Company, upon the Company's receipt of proceeds from an initial public offering of its common stock at any time prior to November 30, 2002 at a redemption price equal to 113.45% of their accreted value plus accrued but unpaid interest. The Company repurchased in the open market \$12.5 million face value of senior discount notes during the fiscal year ended December 30, 2001 for a repurchase price of \$6.7 million. On February 1, 2002 the Company purchased an additional \$2.8 million face value of the senior discount notes for a repurchase price of \$2.5 million. The Company redeemed the remaining \$25.4 million face value of senior discount notes upon completion of its initial public offering in July 2002 for a repurchase price of \$27.5 million.

The Company had a non-amortizing \$125.0 million revolving credit facility, which was amended and restated to a three-year, non-amortizing \$140.0 million revolving credit facility in the first quarter of 2003. The amended and restated credit facility may be terminated by the lenders by giving at least 90 days prior written notice before any anniversary date, commencing with its third anniversary date on March 20, 2006. The Company may terminate the credit facility by giving at least 30 days prior written notice, provided that if the Company terminates prior to March 20, 2006, it must pay an early termination fee. Unless it is terminated, the credit facility will continue on an annual basis from anniversary date to anniversary date beginning on March 21, 2006. The credit facility bears interest at various rates based on the Company's performance, with a floor of LIBOR plus 1.50% or the JP Morgan Chase Bank prime lending rate and a ceiling of LIBOR plus 2.50% or the JP Morgan Chase Bank prime lending rate plus 0.75% and is secured by trade accounts receivable, merchandise inventory and general intangible assets (including trademarks and trade names). At December 28, 2003, loans under the credit facility bear interest at a rate of LIBOR (1.15% at December 28, 2003) plus 1.50% or the JP Morgan Chase Bank prime lending rate (4.00% at December 28, 2003). An annual fee of 0.325%, payable monthly, is assessed on the unused portion of the credit facility. On December 28, 2003, the Company had \$51.7 million in LIBOR and prime lending rate borrowings and letters of credit of \$0.2 million outstanding. The Company's maximum eligible borrowing available under the credit facility is limited to 70% of the aggregate value of eligible inventory during November through February and 65% of the aggregate value of eligible inventory during the remaining months of the year. Available borrowing capacity over and above actual borrowings and letters of credit outstanding on the credit facility amounted to \$72.9 million at December 28, 2003.

The various debt agreements contain covenants restricting the ability of the Company to, among other things, incur additional debt, create or allow liens, pay dividends, merge or consolidate with or invest in other companies, sell, lease or transfer all or substantially all of its properties or assets, or make certain payments with respect to its outstanding capital stock, issue preferred stock and engage in certain transactions with affiliates. In addition, the Company must comply with certain financial covenants. The Company was in compliance with all such covenants at December 28, 2003.

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(5) Fair Values of Financial Instruments**

The fair value of cash, trade and other receivables, trade accounts payable and accrued expenses approximate the fair values of these instruments due to their short-term nature. The fair value of the 10.875% senior notes at December 28, 2003 approximated \$50.5 million based upon recent market prices. The carrying amount of the credit facility reflects the fair value based on current rates available to the Company for debt with the same remaining maturities.

(6) Leases

The Company currently leases certain stores, distribution facilities, vehicles and equipment under noncancelable operating leases that expire through the year 2019. These leases generally contain renewal options for periods ranging from 5 to 15 years and require the Company to pay all executory costs such as maintenance and insurance.

Certain leases contain escalation clauses and provide for contingent rentals based on percentages of sales. The Company recognizes rental expense on a straight-line basis over the terms of the underlying leases, without regard to when rentals are paid. The accrual of the current non-cash portion of this rental expense has been included in depreciation and amortization in the accompanying statements of operations and cash flows and deferred rent in the accompanying balance sheets.

Rental expense for operating leases consisted of the following:

	Year ended December 30, 2001	Year ended December 29, 2002	Year ended December 28, 2003
Cash rental payments	\$31,602	\$33,693	\$36,768
Noncash rentals	258	195	129
Contingent rentals	1,710	1,730	1,730
	<u> </u>	<u> </u>	<u> </u>
Rental expense	\$33,570	\$35,618	\$38,627
	<u> </u>	<u> </u>	<u> </u>

Future minimum lease payments (cash rentals) under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of December 28, 2003 are:

Year ending:	
2004	\$ 41,024
2005	37,702
2006	33,046
2007	30,296
2008	27,883
Thereafter	100,096

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(7) Accrued Expenses**

Accrued expenses consist of the following:

	December 29, 2002	December 28, 2003
Payroll and related expenses	\$ 13,757	\$ 20,793
Advertising	5,047	4,815
Sales tax	7,810	8,831
Income tax	1,086	3,834
Other	22,008	16,444
	<u>\$ 49,708</u>	<u>\$ 54,717</u>

(8) Income Taxes

Total income tax expense (benefit) consists of the following:

	Current	Deferred	Total
2003:			
Federal	\$ 14,452	\$ (154)	\$ 14,297
State	3,106	184	3,290
	<u>\$ 17,558</u>	<u>\$ 30</u>	<u>\$ 17,587</u>
2002:			
Federal	\$ 7,514	\$ 4,188	\$ 11,702
State	1,749	(138)	1,611
	<u>\$ 9,263</u>	<u>\$ 4,050</u>	<u>\$ 13,313</u>
2001:			
Federal	\$ 7,698	\$ 711	\$ 8,409
State	1,776	95	1,871
	<u>\$ 9,474</u>	<u>\$ 806</u>	<u>\$ 10,280</u>

The provision for income taxes differs from the amounts computed by applying the federal statutory tax rate of 35% to earnings before income taxes, as follows:

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	Year ended December 30, 2001	Year ended December 29, 2002	Year ended December 28, 2003
Tax expense at statutory rate	\$ 8,836	\$ 11,338	\$ 15,357
State taxes, net of federal benefit	1,223	1,475	2,131
Other	221	500	99
	<u> </u>	<u> </u>	<u> </u>
	\$ 10,280	\$ 13,313	\$ 17,587
	<u> </u>	<u> </u>	<u> </u>

F-15

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Deferred tax assets and liabilities consist of the following tax-effected temporary differences:

	December 29, 2002	December 28, 2003
Deferred assets:		
Self-insurance reserves	\$ 2,341	\$ 2,593
Employee benefits	2,384	2,819
State taxes	611	1,087
Accrued expenses	4,638	4,556
Tax credits	791	680
Other	410	291
	<u> </u>	<u> </u>
Deferred tax assets	\$ 11,175	\$ 12,026
Deferred liabilities – basis difference in fixed assets	\$ 1,517	\$ 2,398
	<u> </u>	<u> </u>
Net deferred tax assets	\$ 9,658	\$ 9,628
	<u> </u>	<u> </u>

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversals of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections of future taxable income over the periods during which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry-forward period are reduced.

(9) Employee Benefit Plans

The Company has a 401(k) plan covering eligible employees. Employee contributions may be supplemented by Company contributions. The Company contributed \$1.8 million for the fiscal year ended December 30, 2001, \$2.0 million for the fiscal year ended December 29, 2002 and \$2.0 million for the fiscal year ended December 28, 2003 in employer matching and profit sharing contributions.

The Company has an employment agreement with Robert W. Miller, chairman emeritus, that stipulates upon his retirement he will receive \$350 thousand per year for the remainder of his life. Upon his death, his spouse will continue to receive this benefit for the remainder of her life. The Company has recorded a liability of \$0.6 million and \$1.2 million as of December 29, 2002 and December 28, 2003, respectively, based on actuarial valuation estimates related to the employment agreement with the executive. The actuarial assumptions used included a discount rate of 6.50% as well as the use of a mortality table as of December 28, 2003.

(10) Related Party Transactions

Green Equity Investors, L.P. and Grand Avenue Associates, L.P., both affiliates of Leonard Green & Partners, L.P., purchased an aggregate of 350,000 shares of the Company's common stock at the initial public offering price of \$13.00 per share. Green Equity Investors, L.P. owned more than 27% of our outstanding common stock until it sold substantially all of its shares in a secondary public offering in November 2003.

Table of Contents

BIG 5 SPORTING GOODS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Prior to September 1992, Big 5 Corp. was a wholly owned subsidiary of Thrifty Corporation (Thrifty), which was in turn a wholly owned subsidiary of Pacific Enterprises (PE). In December 1996, Thrifty was acquired by Rite Aid Corp. (Rite Aid).

As a result of the Company's prior relationship with Thrifty and its affiliates, the Company continues to maintain certain relationships with Rite Aid, PE and PE's successor company, Sempra Energy. These relationships include continuing indemnification obligations of PE to the Company for certain environmental matters; agreements between the Company and PE with respect to various tax matters and obligations under ERISA, including the allocation of various tax obligations relating to the inclusion of the Company and each member of the affiliated group of which the Company was a subsidiary in certain consolidated and/or unitary tax returns of PE, and subleases described as follows. Green Equity Investors III, L.P., an affiliate of Leonard Green & Partners, L.P., holds convertible preferred stock in Rite Aid, which, if converted, would represent approximately 12.2% of Rite Aid's outstanding stock.

The Company leases certain property and equipment from Rite Aid, which leases this property and equipment from an outside party. Charges related to these leases totaled \$0.2 million for the fiscal years ended December 30, 2001, December 29, 2002 and December 28, 2003.

The Company had a Management Services Agreement with Leonard Green & Associates, L.P., an affiliate of Leonard Green & Partners, L.P., which was due to expire in May 2005, under which \$0.3 million, plus expenses, was paid annually for financial advisory and investment banking services. The agreement was terminated in conjunction with the initial public offering in fiscal 2002 for a fee of \$0.9 million. During each of the fiscal years ended December 30, 2001 and December 29, 2002 the Company paid \$0.3 million and \$1.0 million to this advisor group, respectively.

On July 2, 2002, the Company used a portion of the net proceeds from its initial public offering to redeem all of the Company's outstanding shares of Series A 13.45% senior exchangeable preferred stock, par value \$0.01 per share, (Preferred Stock). Green Equity Investors, L.P. and its affiliates owned 309,071 of the 350,000 outstanding shares of preferred stock and received approximately \$60.6 million upon redemption of such shares.

The Company has an employment agreement with Robert W. Miller which provides that he will serve as Chairman Emeritus of the Board of Directors for a term of three years from any given date, such that there will always be a minimum of at least three years remaining under his employment agreement. The employment agreement provides for Robert W. Miller to receive an annual base salary of \$350,000, as well as specified perquisites. If Robert W. Miller's employment is terminated by either Robert W. Miller or the Company for any reason, the employment agreement provides that the Company will pay Robert W. Miller his annual base salary and provide specified benefits for the remainder of his life. The employment agreement also provides that in the event Robert W. Miller is survived by his wife, the Company will pay his wife his annual base salary and provide her specified benefits for the remainder of her life. Robert W. Miller is the co-founder of the Company and the father of Steven G. Miller, Chairman of the Board, Chief Executive Officer and a director of the Company, and Michael D. Miller, a director of the Company.

(11) Contingencies

On August 9, 2001, the Company received a copy of a complaint filed in the California Superior Court in Los Angeles alleging violations of the California Labor Code and the Business and Professions Code. This complaint was brought as a purported class action with two subclasses comprised of our California store managers and our California first assistant store managers. The plaintiffs alleged that the Company improperly classified its store managers and first assistant store managers as exempt employees not entitled to overtime pay for work in excess of forty hours per week. On February 8, 2002 the Company filed a joint settlement which was approved by the court on August 1, 2002. The settlement constitutes a full and complete settlement

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

and release of all claims related to the lawsuit. Under the terms of the settlement, the Company agreed to pay \$32.46 per week of active employment as store manager from August 8, 1997 through December 31, 2001, the covered period, and \$25.50 per week of active employment as first assistant store manager during the covered period to each class member who submits a valid and timely claim form. The Company also agreed to pay attorneys' fees, plus costs and expenses, in the amount of \$0.7 million, as well as up to \$0.04 million for the cost of the settlement administrator. In addition, the Company agreed to pay the class representatives an additional aggregate amount of \$0.03 million for their service as named plaintiffs. The Company recorded a charge of approximately \$2.5 million in the fourth quarter of fiscal 2001 to provide for expected payments to the class members as well as legal and other fees associated with the settlement. All payments under the settlement agreement were made as of December 29, 2002.

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

(12) Business Concentrations

The Company operates traditional sporting goods retail stores located principally in the Western states of the United States. The Company is subject to regional risks such as the local economies, weather conditions and natural disasters and government regulations. If the region were to suffer an economic downturn or if other adverse regional events were to occur that affect the retail industry, there could be a significant adverse effect on management's estimates and an adverse impact on the Company's performance.

(13) Quarterly Financial Data (unaudited)**Year Ended December 29, 2002**

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
(In thousands, except per share data)					
Net sales	\$ 157,133	\$ 162,703	\$ 170,913	\$ 176,720	\$ 667,469
Gross profit	\$ 55,007	\$ 59,633	\$ 59,107	\$ 63,864	\$ 237,611
Net income	\$ 3,530	\$ 4,129	\$ 2,596	\$ 8,827	\$ 19,082
Net income per share (diluted)	\$ 0.10	\$ 0.13	\$ (0.06)	\$ 0.39	\$ 0.57
Diluted shares	16,087	16,512	22,156	22,664	19,476

Year Ended December 28, 2003

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
(In thousands, except per share data)					
Net sales	\$ 164,517	\$ 170,125	\$ 183,275	\$ 191,823	\$ 709,740
Gross profit	\$ 57,852	\$ 62,595	\$ 65,210	\$ 70,269	\$ 255,926
Net income	\$ 3,397	\$ 6,268	\$ 6,744	\$ 9,881	\$ 26,290
Net income per share (diluted)	\$ 0.15	\$ 0.28	\$ 0.30	\$ 0.43	\$ 1.16
Diluted shares	22,664	22,730	22,781	22,832	22,753

(14) Redeemable Preferred Stock

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In November 1997, the Company authorized and issued 350,000 shares of Series A 13.45% senior exchangeable preferred stock with a liquidation preference of \$100.00 per share as of the date of issue. The preferred stock had a liquidation preference over the common stock equal to the initial liquidation value of the preferred stock plus accrued and unpaid dividends thereon. On July 2, 2002, the Company used a portion of

F-18

Table of Contents

BIG 5 SPORTING GOODS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the net proceeds from its initial public offering to redeem all of the Company's outstanding shares of preferred stock.

The preferred stock earned cumulative dividends at the rate of 13.45% per annum. Dividends could, at the option of the Company, be paid in cash or by adding to the liquidation preference of preferred stock an amount equal to the dividends then accrued and payable. The preferred stock was subject to mandatory redemption on November 13, 2009 at 100% of the liquidation preference plus accrued and unpaid dividends. Prior to November 13, 2002, the Company could redeem the preferred stock following an initial public offering of common stock at 110% of the liquidation preference, less an amount (calculated as a percentage) sufficient to reduce the aggregate redemption price by an amount sufficient to permit the Company to pay bonuses to the Company's directors and executive officers who sold shares of the Company's common stock in the initial public offering in an amount equal to the underwriting commission and discounts that they would pay, as well as to repurchase 0.5 million shares from the Company's other non-executive employees relating to such offering at the offering price to the public rather than the net price to the Company after deducting underwriting commissions and discounts, plus accrued and unpaid dividends.

**(15) Stock Options, Restricted Stock and Warrant
1997 Management Equity Plan**

The 1997 Plan provides for the sale of shares or granting of incentive stock options or non-qualified stock options to officers, directors and selected key employees of the Company to purchase shares of the Company's common stock. The 1997 Plan is administered by the board of directors of the Company and the granting of awards under the 1997 Plan is discretionary with respect to the individuals to whom and the times at which awards are made, the number of options awarded or shares sold, and the vesting and exercise period of such awards. The options and stock granted under the 1997 Plan must have an exercise or sale price that is no less than 85% of the fair value of the Company's common stock at the time the stock option or stock is granted or sold. The aggregate number of common shares that may be allocated to awards under the 1997 Plan is 4,536,000 shares. No more than 810,000 of these shares shall be subject to stock options outstanding at any time. Options granted or restricted stock sold under the 1997 Plan vest ratably over five years from the date the options are granted or the restricted stock is issued and have an exercise period not to exceed 120 months from the date the stock options are granted or the restricted stock is issued. The 1997 Plan does not allow for the transfer of options or stock purchase rights. As of December 30, 2001 and December 29, 2002, no options had been granted under the 1997 Plan and 3,744,702 shares of restricted common stock had been sold under the 1997 Plan. The Company does not intend to make additional grants under the 1997 Plan. At December 28, 2003, all shares granted under the 1997 Plan were fully vested.

Warrant

In connection with the issuance of the senior discount notes in 1997, the Company issued a warrant to purchase 486,000 shares of common stock. The warrant was exercisable at any time with an exercise price of \$.00123 per share and would have expired on November 30, 2008. The fair value of the warrant at the time of issuance was \$0.3 million, determined by cash purchases of common stock by third parties on the same date. The warrant was exercised in the first quarter of fiscal 2003.

2002 Stock Incentive Plan

In June 2002, the Company adopted the 2002 Stock Incentive Plan (2002 Plan). The 2002 Plan provides for the grant of incentive stock options and non-qualified stock options to the Company's employees, directors, and specified consultants. Under the 2002 Plan, the Company may grant options to purchase up to 3,645,000 shares of common stock. Options granted under the 2002 Plan vest ratably over various terms with a

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

maximum life of ten years. At December 28, 2003, options to purchase 383,400 shares of common stock had been granted and remain outstanding under the 2002 Plan.

Stock option activity for all plans during the periods presented is as follows:

	<u>No. of Shares</u>	<u>Weighted Average Exercise Price</u>
Balance at December 30, 2001		
Granted	61,000	\$ 12.91
Exercised		
Forfeited		
	<u>61,000</u>	<u>12.91</u>
Balance at December 29, 2002	61,000	12.91
Granted	339,800	10.32
Exercised		
Forfeited	(17,400)	10.69
	<u>383,400</u>	<u>\$ 10.72</u>

The following is a summary of stock options outstanding and exercisable at December 28, 2003:

Range of Exercise Prices	Outstanding			Exercisable	
	Number of Options	Weighted Average Years Remaining	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$10.50	2,000	8.5	\$ 10.50	14,150	\$ 10.50
13.00	56,600	8.5	13.00	500	13.00
10.32	324,800	9.1	\$ 10.32	6,250	10.32

(16) Earnings Per Share

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

	<u>Year ended December 30, 2001</u>	<u>Year ended December 29, 2002</u>	<u>Year ended December 28, 2003</u>
Net income	\$ 14,965	\$ 19,082	\$ 26,290
Less: Preferred stock dividends	7,284	7,999	
	<u>\$ 7,681</u>	<u>\$ 11,083</u>	<u>\$ 26,290</u>
Net income available to common stockholders	\$ 7,681	\$ 11,083	\$ 26,290

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Basic earnings per share	\$ 0.54	\$ 0.60	\$ 1.16
Diluted earnings per share	\$ 0.48	\$ 0.57	\$ 1.16
Weighted average shares of common stock outstanding:			
Basic	14,247	18,358	22,651
Dilutive effect of common stock equivalents arising from stock options			87
Dilutive effect of unvested restricted stock	1,357	632	
Dilutive effect of outstanding warrant	486	486	15
Diluted	16,090	19,476	22,753

F-20

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(17) Goodwill**

In accordance with SFAS No. 142, goodwill amortization was discontinued as of December 31, 2001. There was no cumulative effect of a change in accounting principle upon adoption, as there was deemed to be no impairment in the carrying value of goodwill or other identifiable intangibles. The following adjusts reported net income and earnings per share to exclude goodwill amortization:

	Year Ended		
	December 30, 2001	December 29, 2002	December 28, 2003
(In thousands, except earnings per share data)			
Reported net income	\$ 14,965	\$ 19,082	\$ 26,290
Goodwill amortization, net of tax	146		
Adjusted net income	15,111	19,082	26,290
Less: Preferred stock dividends	7,284	7,999	
Adjusted net income available to common stockholders	\$ 7,827	\$ 11,083	\$ 26,290
Reported basic earnings per share	\$ 0.54	\$ 0.60	\$ 1.16
Goodwill amortization, net of tax	0.01		
Adjusted basic earnings per share	\$ 0.55	\$ 0.60	\$ 1.16
Reported diluted earnings per share	\$ 0.48	\$ 0.57	\$ 1.16
Goodwill amortization, net of tax	0.01		
Adjusted diluted earnings per share	\$ 0.49	\$ 0.57	\$ 1.16

F-21

Table of Contents**BIG 5 SPORTING GOODS CORPORATION****Schedule II Valuation and Qualifying Accounts**

	Balance at Beginning of Year	Additions: Charges to Operations	Deductions: Accounts Receivable Write Offs	Balance at End of Year
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	(Dollars in thousands)			
December 31, 2000				
Allowance for doubtful receivables	607	129	(65)	671
December 29, 2002				
Allowance for doubtful receivables	671	120	(62)	729
December 28, 2003				
Allowance for doubtful receivables	729	170	(380)	520

II-1