

GUESS INC  
Form 10-Q  
June 11, 2013  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended May 4, 2013

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 1-11893  
GUESS?, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

95-3679695

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

1444 South Alameda Street

Los Angeles, California

(Address of principal executive offices)

(213) 765-3100

(Registrant's telephone number, including area code)

90021

(Zip Code)

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of June 6, 2013 the registrant had 84,847,526 shares of Common Stock, \$.01 par value per share, outstanding.



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GUESS?, INC.

FORM 10-Q

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## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements.

## GUESS?, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

|  | May 4,<br>2013<br>(unaudited) | Feb 2,<br>2013 |
|--|-------------------------------|----------------|
| <b>ASSETS</b>  |                               |                |
| Current assets:  |                               |                |
| Cash and cash equivalents  | \$306,437                     | \$329,021      |
| Short-term investments   | 6,911                         | 6,906          |
| Accounts receivable, net   | 251,071                       | 316,863        |
| Inventories  | 375,793                       | 369,712        |
| Other current assets   | 117,430                       | 84,723         |
| Total current assets   | 1,057,642                     | 1,107,225      |
| Property and equipment, net  | 346,268                       | 355,729        |
| Goodwill   | 38,407                        | 39,287         |
| Other intangible assets, net   | 17,452                        | 16,032         |
| Long-term deferred tax assets  | 42,513                        | 43,063         |
| Other assets   | 119,186                       | 152,170        |
|  | \$1,621,468                   | \$1,713,506    |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                               |                |
| Current liabilities:   |                               |                |
| Current portion of capital lease obligations and borrowings  | \$1,931                       | \$1,901        |
| Accounts payable   | 178,086                       | 191,143        |
| Accrued expenses   | 162,779                       | 191,922        |
| Total current liabilities  | 342,796                       | 384,966        |
| Capital lease obligations  | 7,559                         | 8,314          |
| Deferred rent and lease incentives   | 92,511                        | 94,218         |
| Other long-term liabilities  | 119,650                       | 121,996        |
|  | 562,516                       | 609,494        |
| Redeemable noncontrolling interests  | 3,301                         | 3,144          |
| Commitments and contingencies (Note 11)  |                               |                |
| Stockholders' equity:  |                               |                |
| Preferred stock, \$.01 par value. Authorized 10,000,000 shares; no shares issued and outstanding   | —                             | —              |
| Common stock, \$.01 par value. Authorized 150,000,000 shares; issued 139,098,739 and 138,812,082 shares, outstanding 84,785,043 and 85,367,984 shares, at May 4, 2013 and February 2, 2013, respectively | 848                           | 853            |
| Paid-in capital  | 426,546                       | 423,387        |
| Retained earnings  | 1,155,793                     | 1,162,982      |
| Accumulated other comprehensive loss   | (23,201)                      | ) (2,461 )     |
| Treasury stock, 54,313,696 and 53,444,098 shares at May 4, 2013 and February 2, 2013, respectively   | (519,747)                     | ) (497,769 )   |
| Guess?, Inc. stockholders' equity  | 1,040,239                     | 1,086,992      |
| Nonredeemable noncontrolling interests   | 15,412                        | 13,876         |

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|                            |             |             |
|----------------------------|-------------|-------------|
| Total stockholders' equity | 1,055,651   | 1,100,868   |
|                            | \$1,621,468 | \$1,713,506 |

See accompanying notes to condensed consolidated financial statements.

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GUESS?, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 (in thousands, except per share data)  
 (unaudited)

|  | Three Months Ended |                 |
|--|--------------------|-----------------|
|  | May 4,<br>2013     | Apr 28,<br>2012 |
| Product sales  | \$518,664          | \$550,366       |
| Net royalties  | 30,250             | 28,900          |
| Net revenue  | 548,914            | 579,266         |
| Cost of product sales  | 351,488            | 344,190         |
| Gross profit   | 197,426            | 235,076         |
| Selling, general and administrative expenses   | 183,764            | 195,935         |
| Restructuring charges  | 2,337              | —               |
| Earnings from operations   | 11,325             | 39,141          |
| Other income (expense):  |                    |                 |
| Interest expense   | (549)              | (384)           |
| Interest income  | 334                | 694             |
| Other income, net  | 5,457              | 568             |
|  | 5,242              | 878             |
| Earnings before income tax expense   | 16,567             | 40,019          |
| Income tax expense   | 5,467              | 12,806          |
| Net earnings   | 11,100             | 27,213          |
| Net earnings attributable to noncontrolling interests                                    | 1,184              | 567             |
| Net earnings attributable to Guess?, Inc.  | \$9,916            | \$26,646        |
| Net earnings per common share attributable to common stockholders (Note 2):              |                    |                 |
| Basic  | \$0.12             | \$0.30          |
| Diluted  | \$0.12             | \$0.30          |
| Weighted average common shares outstanding attributable to common stockholders (Note 2): |                    |                 |
| Basic  | 84,582             | 89,190          |
| Diluted  | 84,778             | 89,510          |
| Dividends declared per common share  | \$0.20             | \$0.20          |
| See accompanying notes to condensed consolidated financial statements.                   |                    |                 |

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## GUESS?, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(in thousands)

(unaudited)

|  | Three Months Ended |                 |
|--|--------------------|-----------------|
|  | May 4,<br>2013     | Apr 28,<br>2012 |
| Net earnings   | \$ 11,100          | \$ 27,213       |
| Other comprehensive income (loss):                                     |                    |                 |
| Foreign currency translation adjustment                                |                    |                 |
| Gains (losses) arising during the period                               | (32,011            | ) 3,641         |
| Less income tax effect   | 7,597              | (921            |
| Derivative financial instruments designated as cash flow hedges        |                    |                 |
| Gains (losses) arising during the period                               | 4,670              | (874            |
| Less income tax effect   | (582               | ) 380           |
| Reclassification to net income for gains realized                      | (458               | ) (2,621        |
| Less income tax effect   | 70                 | 321             |
| Marketable securities  |                    |                 |
| Gains arising during the period  | 99                 | 232             |
| Less income tax effect   | (40                | ) (89           |
| Supplemental Executive Retirement Plan ("SERP")                        |                    |                 |
| Actuarial loss amortization  | 277                | 835             |
| Prior service cost amortization  | 155                | 155             |
| Less income tax effect   | (165               | ) (378          |
| Total comprehensive income (loss)                                      | (9,288             | ) 27,894        |
| Less comprehensive income attributable to noncontrolling interests:    |                    |                 |
| Net earnings   | 1,184              | 567             |
| Foreign currency translation adjustment                                | 352                | 2               |
| Amounts attributable to noncontrolling interests                       | 1,536              | 569             |
| Comprehensive income (loss) attributable to Guess?, Inc.               | \$(10,824          | ) \$27,325      |
| See accompanying notes to condensed consolidated financial statements. |                    |                 |

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GUESS?, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands)  
 (unaudited)

|   | Three Months Ended |                 |
|---|--------------------|-----------------|
|   | May 4,<br>2013     | Apr 28,<br>2012 |
| Cash flows from operating activities:   |                    |                 |
| Net earnings  | \$11,100           | \$27,213        |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                    |                 |
| Depreciation and amortization of property and equipment                             | 21,910             | 20,247          |
| Amortization of intangible assets   | 598                | 474             |
| Share-based compensation expense  | 2,248              | 4,802           |
| Unrealized forward contract (gains) losses  | (2,409)            | ) 1,465         |
| Net loss on disposition of property and equipment                                   | 1,348              | 81              |
| Other items, net  | (1,092)            | ) (537)         |
| Changes in operating assets and liabilities:  |                    |                 |
| Accounts receivable   | 56,840             | 5,629           |
| Inventories   | (12,443)           | ) (6,204)       |
| Prepaid expenses and other assets   | (9,292)            | ) 5,911         |
| Accounts payable and accrued expenses   | (33,241)           | ) (32,387)      |
| Deferred rent and lease incentives  | (1,330)            | ) 2,991         |
| Other long-term liabilities   | (2,500)            | ) 6,968         |
| Net cash provided by operating activities   | 31,737             | 36,653          |
| Cash flows from investing activities:   |                    |                 |
| Purchases of property and equipment   | (17,272)           | ) (25,441)      |
| Changes in other long-term assets   | 7,133              | (8,291)         |
| Acquisition of businesses, net of cash acquired                                     | (653)              | ) —             |
| Net cash settlement of forward contracts  | 661                | 2,348           |
| Net cash used in investing activities   | (10,131)           | ) (31,384)      |
| Cash flows from financing activities:   |                    |                 |
| Proceeds from short-term borrowings   | 152                | —               |
| Repayment of borrowings and capital lease obligations                               | (480)              | ) (491)         |
| Dividends paid  | (17,129)           | ) (18,087)      |
| Issuance of common stock, net of nonvested award repurchases                        | 1,704              | 1,078           |
| Excess tax benefits from share-based compensation                                   | 2                  | 18              |
| Purchase of treasury stock  | (22,099)           | ) —             |
| Net cash used in financing activities   | (37,850)           | ) (17,482)      |
| Effect of exchange rates on cash and cash equivalents                               | (6,340)            | ) 761           |
| Net change in cash and cash equivalents   | (22,584)           | ) (11,452)      |
| Cash and cash equivalents at beginning of period                                    | 329,021            | 491,805         |
| Cash and cash equivalents at end of period  | \$306,437          | \$480,353       |
| Supplemental cash flow data:  |                    |                 |
| Interest paid   | \$237              | \$181           |
| Income taxes paid   | \$11,045           | \$6,137         |
| See accompanying notes to condensed consolidated financial statements.              |                    |                 |





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GUESS?, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

May 4, 2013

(unaudited)

(1) Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements of Guess?, Inc. and its subsidiaries (the "Company") contain all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the condensed consolidated balance sheets as of May 4, 2013 and February 2, 2013, and the condensed consolidated statements of income, comprehensive income (loss) and cash flows for the three months ended May 4, 2013 and April 28, 2012. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and the instructions to Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (the "SEC"). Accordingly, they have been condensed and do not include all of the information and footnotes required by GAAP for complete financial statements. The results of operations for the three months ended May 4, 2013 are not necessarily indicative of the results of operations to be expected for the full fiscal year. These financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended February 2, 2013.

The Company has made certain reclassifications to the prior year's consolidated financial statements to conform to classifications in the current year. This reclassification had no impact on previously reported results from operations or net cash provided by operating activities.

The three months ended May 4, 2013 had the same number of days as the three months ended April 28, 2012. All references herein to "fiscal 2014", "fiscal 2013" and "fiscal 2012" represent the results of the 52-week fiscal year ending February 1, 2014, the 53-week fiscal year ended February 2, 2013 and the 52-week fiscal year ended January 28, 2012, respectively.

Restructuring Charges

During the first quarter of fiscal 2014, the Company implemented plans to streamline its operational structure and reduce expenses in both Europe and North America which resulted in restructuring charges of \$2.3 million related primarily to severance costs. During the first quarter of fiscal 2014, the Company had a balance of approximately \$1.4 million in accrued expenses for amounts expected to be paid during the remainder of fiscal 2014. As of May 4, 2013, the Company had incurred substantially all charges related to the implementation of these plans.

New Accounting Guidance

In February 2013, the Financial Accounting Standards Board ("FASB") issued authoritative guidance that requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income (loss) by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income (loss) by the respective line items of net income but only if the amount reclassified is required under GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under GAAP that provide additional detail about those amounts. The Company adopted this guidance effective February 3, 2013 and accordingly has presented the required comprehensive income disclosures in the accompanying notes to the condensed consolidated financial statements.

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## (2) Earnings Per Share

Basic earnings per share represents net earnings attributable to common stockholders divided by the weighted-average number of common shares outstanding for the period. Diluted earnings per share represents net earnings attributable to common stockholders divided by the weighted-average number of common shares outstanding, inclusive of the dilutive impact of common equivalent shares outstanding during the period. However, nonvested restricted stock awards (referred to as participating securities) are excluded from the dilutive impact of common equivalent shares outstanding in accordance with authoritative guidance under the two-class method since the nonvested restricted stockholders are entitled to participate in dividends declared on common stock as if the shares were fully vested and hence are deemed to be participating securities. Under the two-class method, earnings attributable to nonvested restricted stockholders are excluded from net earnings attributable to common stockholders for purposes of calculating basic and diluted earnings per common share.

The computation of basic and diluted net earnings per common share attributable to common stockholders is as follows (in thousands, except per share data):

|   | Three Months Ended |              |
|---|--------------------|--------------|
|   | May 4, 2013        | Apr 28, 2012 |
| Net earnings attributable to Guess?, Inc.                           | \$9,916            | \$26,646     |
| Less net earnings attributable to nonvested restricted stockholders | 89                 | 169          |
| Net earnings attributable to common stockholders                    | \$9,827            | \$26,477     |
| Weighted average common shares used in basic computations           | 84,582             | 89,190       |
| Effect of dilutive securities:                                      |                    |              |
| Stock options and restricted stock units                            | 196                | 320          |
| Weighted average common shares used in diluted computations         | 84,778             | 89,510       |
| Net earnings per common share attributable to common stockholders:  |                    |              |
| Basic   | \$0.12             | \$0.30       |
| Diluted   | \$0.12             | \$0.30       |

For the three months ended May 4, 2013 and April 28, 2012, equity awards granted for 1,353,455 and 1,205,081, respectively, of the Company's common shares were outstanding but were excluded from the computation of diluted weighted average common shares and common share equivalents outstanding because their effect would have been anti-dilutive.

On March 14, 2011, the Company's Board of Directors authorized a program to repurchase, from time-to-time and as market and business conditions warrant, up to \$250 million of the Company's common stock (the "2011 Share Repurchase Program"). On June 26, 2012, the Company's Board of Directors authorized a new program to repurchase, from time-to-time and as market and business conditions warrant, up to \$500 million of the Company's common stock (the "2012 Share Repurchase Program"). The 2012 Share Repurchase Program was in addition to the existing 2011 Share Repurchase Program. Repurchases under either program may be made on the open market or in privately negotiated transactions, pursuant to Rule 10b5-1 trading plans or other available means. There is no minimum or maximum number of shares to be repurchased under either program and programs may be discontinued at any time, without prior notice. During the three months ended May 4, 2013, the Company repurchased 882,551 shares under the 2011 and 2012 Share Repurchase Programs at an aggregate cost of \$22.1 million. At May 4, 2013, the Company had remaining authority under the 2012 Share Repurchase Program to purchase \$495.8 million of its common stock and no remaining authority to purchase shares under the 2011 Share Repurchase Program.

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## (3) Stockholders' Equity and Redeemable Noncontrolling Interests

A reconciliation of the total carrying amount of total stockholders' equity, Guess?, Inc. stockholders' equity and stockholders' equity attributable to nonredeemable and redeemable noncontrolling interests for the fiscal year ended February 2, 2013 and three months ended May 4, 2013 is as follows (in thousands):

|  | Stockholders' Equity                    |  |             | Redeemable<br>Noncontrolling<br>Interests |   |
|--|---|--|-------------|---|---|
|  | Guess?, Inc.<br>Stockholders'<br>Equity | Nonredeemable<br>Noncontrolling<br>Interests | Total       |   |   |
| Balances at January 28, 2012   | \$1,175,630                             | \$ 18,635                                    | \$1,194,265 | \$ 8,293                                  |   |
| Net earnings   | 178,744                                 | 2,742  | 181,486     | —   |   |
| Foreign currency translation adjustment, net of income tax of (\$13,769)   | 22,025                                  | 322  | 22,347      | 65  |   |
| Loss on derivative financial instruments designated as cash flow hedges, net of income tax of \$1,056                | (6,041                                  | ) —  | (6,041      | ) —                                       |   |
| Gain on marketable securities, net of income tax of (\$85)   | 139                                     | —  | 139         | —   |   |
| SERP prior service cost and actuarial valuation gain (loss) and related amortization, net of income tax of (\$2,855) | 4,613                                   | —  | 4,613       | —   |   |
| Issuance of common stock under stock compensation plans, net of tax effect   | 1,362                                   | —  | 1,362       | —   |   |
| Issuance of stock under ESPP   | 1,186                                   | —  | 1,186       | —   |   |
| Share-based compensation   | 16,285                                  | —  | 16,285      | —   |   |
| Dividends  | (172,792                                | ) —  | (172,792    | ) —                                       |   |
| Share repurchases  | (140,262                                | ) —  | (140,262    | ) —                                       |   |
| Purchase of redeemable noncontrolling interest   | 4,857                                   | (4,857                                       | ) —         | (4,185                                    | ) |
| Noncontrolling interest capital contribution   | —                                       | 1,488  | 1,488       | —   |   |
| Noncontrolling interest capital distribution   | —                                       | (4,237                                       | ) (4,237    | ) —                                       |   |
| Redeemable noncontrolling interest redemption value adjustment   | 1,246                                   | (217   | ) 1,029     | (1,029                                    | ) |
| Balances at February 2, 2013   | \$1,086,992                             | \$ 13,876                                    | \$1,100,868 | \$ 3,144                                  |   |
| Net earnings   | 9,916                                   | 1,184  | 11,100      | —   |   |
| Foreign currency translation adjustment, net of income tax of \$7,597  | (24,766                                 | ) 352  | (24,414     | ) (121                                    | ) |
| Gain on derivative financial instruments designated as cash flow hedges, net of income tax of (\$512)                | 3,700                                   | —  | 3,700       | —   |   |
| Gain on marketable securities, net of income tax of (\$40)   | 59                                      | —  | 59          | —   |   |
| SERP prior service cost and actuarial valuation amortization, net of income tax of (\$165)                           | 267                                     | —  | 267         | —   |   |
| Issuance of common stock under stock compensation plans, net of tax effect   | 1,058                                   | —  | 1,058       | —   |   |
| Issuance of stock under ESPP   | 270                                     | —  | 270         | —   |   |
| Share-based compensation   | 2,248                                   | —  | 2,248       | —   |   |
| Dividends  | (17,128                                 | ) —  | (17,128     | ) —                                       |   |
| Share repurchases  | (22,099                                 | ) —  | (22,099     | )   |   |
| Redeemable non-controlling interest redemption value adjustment  | (278                                    | ) —  | (278        | ) 278                                     |   |
| Balances at May 4, 2013  | \$1,040,239                             | \$ 15,412                                    | \$1,055,651 | \$ 3,301                                  |   |



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## Accumulated Other Comprehensive Income (Loss)

The changes in accumulated other comprehensive income (loss), net of related income taxes, for the three months ended May 4, 2013 are as follows (in thousands):

|  | Foreign<br>currency<br>translation<br>adjustment | Derivative<br>financial<br>instruments<br>designated<br>as cash flow<br>hedges | Marketable<br>securities | SERP         | Total        |
|--|--|--|--------------------------|--------------|--------------|
| Balances at February 2, 2013                               | \$10,618   | \$ (1,782 )  | \$ 110                   | \$ (11,407 ) | \$ (2,461 )  |
| Gains (losses) arising during the period                   | (24,766 )  | 4,088  | 59                       | —            | (20,619 )    |
| Reclassification to net income for (gains) losses realized | —  | (388 )   | —                        | 267          | (121 )       |
| Net other comprehensive income (loss)                      | (24,766 )  | 3,700  | 59                       | 267          | (20,740 )    |
| Balances at May 4, 2013                                    | \$ (14,148 )                                     | \$ 1,918   | \$ 169                   | \$ (11,140 ) | \$ (23,201 ) |

Details on reclassifications out of accumulated other comprehensive income (loss) to net income during the three months ended May 4, 2013 are as follows (in thousands):

|   | Three Months Ended<br>May 4, 2013 | Location of<br>(Gain)/Loss<br>Reclassified from<br>Accumulated OCI<br>into Income |
|---|-----------------------------------|---|
| Derivative financial instruments designated as cash flow hedges:  |                                   |   |
| Foreign exchange currency contracts                               | \$ (479 )                         | ) Cost of sales   |
| Foreign exchange currency contracts                               | 21                                | ) Other income/expense  |
| Less income tax effect  | 70                                | ) Income tax expense  |
|   | (388 )                            | )   |
| SERP:   |                                   |   |
| Actuarial loss amortization                                       | 277                               | (1)   |
| Prior service cost amortization                                   | 155                               | (1)   |
| Less income tax effect  | (165 )                            | ) Income tax expense  |
|   | 267                               |   |
| Total reclassifications during the three months ended May 4, 2013 | \$ (121 )                         | )   |

(1) These accumulated other comprehensive income (loss) components are included in the computation of net periodic pension cost. Refer to Note 12 for further information.

## Redeemable Noncontrolling Interests

The Company is party to a put arrangement with respect to the common securities that represent the remaining noncontrolling interest from the acquisition of its majority-owned subsidiary, Guess Sud SAS (“Guess Sud”). The put arrangement for Guess Sud, representing 40% of the total outstanding equity interest of that subsidiary, may be exercised at the discretion of the noncontrolling interest holders by providing written notice to the Company any time after January 30, 2012. The put arrangement is recorded on the balance sheet at its expected redemption value and classified as a redeemable noncontrolling interest outside of permanent equity. On May 15, 2012, the Company and the noncontrolling interest holders executed an amendment to the Guess Sud put arrangement which modified the put price to be based on the value of specified net tangible and intangible assets of Guess Sud instead of being based on a multiple of Guess Sud’s earnings before interest, taxes, depreciation and amortization. The redemption value of the Guess Sud redeemable put arrangement was \$3.3 million and \$3.1 million at May 4, 2013 and February 2, 2013, respectively.

The Company was previously party to a put arrangement in connection with its now wholly-owned subsidiary, Focus Europe S.r.l. ("Focus"). Under the terms of this put arrangement, which represented 25% of the total outstanding interest of that subsidiary, the noncontrolling interest holder had the option to exercise the put arrangement at its discretion by providing written notice to the Company no later than June 27, 2012. The redemption value of the put arrangement was determined based on a multiple of Focus's net earnings. In June 2012, the noncontrolling interest holder notified the Company of its intent to exercise the put arrangement. On July 9,

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2012, the Company paid \$4.2 million to the noncontrolling interest holder to acquire the remaining 25% interest in Focus. This amount was determined based on a multiple of Focus's net earnings in accordance with the terms of the put arrangement.

**(4) Accounts Receivable**

Accounts receivable consists of trade receivables relating primarily to the Company's wholesale business in Europe, and to a lesser extent, to its wholesale businesses in North America and Asia. The Company provided for allowances relating to these receivables of \$37.2 million and \$38.4 million at May 4, 2013 and February 2, 2013, respectively. In addition, accounts receivable includes royalty receivables relating to licensing operations of \$9.4 million and \$8.8 million at May 4, 2013 and February 2, 2013, respectively, for which the Company provided for an allowance for doubtful accounts of \$0.3 million at each of the periods ended May 4, 2013 and February 2, 2013. The accounts receivable allowance includes allowances for doubtful accounts, wholesale sales returns and wholesale markdowns. Retail sales returns allowances are included in accrued expenses.

**(5) Inventories**

Inventories consist of the following (in thousands):

|                  | May 4, 2013 | Feb 2, 2013 |
|------------------|-------------|-------------|
| Raw materials    | \$15,437    | \$14,706    |
| Work in progress | 2,593       | 1,765       |
| Finished goods   | 357,763     | 353,241     |
|                  | \$375,793   | \$369,712   |

As of May 4, 2013 and February 2, 2013, the Company had an allowance to write-down inventories to the lower of cost or market of \$23.7 million and \$20.4 million, respectively.

**(6) Income Taxes**

Income tax expense for the interim periods was computed using the effective tax rate estimated to be applicable for the full fiscal year. The Company's effective income tax rate increased to 33.0% for the three months ended May 4, 2013 from 32.0% for the three months ended April 28, 2012.

The Company accrues an amount for its estimate of additional income tax liability which the Company, more likely than not, could incur as a result of the ultimate resolution of the income tax audits ("uncertain tax positions"). The Company reviews and updates the estimates used in the accrual for uncertain tax positions as more definitive information becomes available from taxing authorities, upon completion of tax audits, upon expiration of statutes of limitation, or upon occurrence of other events.

The Company had aggregate accruals for uncertain tax positions, including penalties and interest and net of federal tax benefits, of \$4.4 million at each of the periods ended May 4, 2013 and February 2, 2013.

**Italian Tax Settlement**

Prior to the third quarter of fiscal 2013, the Company received tax audit reports from the Italian tax authority regarding its ongoing audit of one of the Company's Italian subsidiaries for the 2008 and 2009 fiscal years. In September 2012, the Company received a formal tax assessment of approximately \$12 million and understood that similar or even larger assessments for periods subsequent to fiscal 2009 continued to be possible. While the Company disagreed with the positions of the Italian tax authority and was prepared to vigorously defend itself in this matter, the Company continued to work with the Italian tax authority throughout the fourth quarter of fiscal 2013 in an attempt to resolve the dispute through standard tax resolution processes.

In January 2013, to avoid a potentially long and costly litigation process, the Company reached an agreement with the Italian tax authority, which covered fiscal years 2008 through 2013 (with fiscal years 2012 and 2013 remaining subject to final documentation). As a result of the agreement during the fourth quarter of fiscal 2013, the Company recorded a settlement charge of \$12.8 million (including penalty and interest and net of related offsets in other tax jurisdictions) in excess of prior uncertain tax position reserves of \$11.7 million. As part of



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the agreement, a portion of the amount payable to the Italian tax authority will be payable in four installments during fiscal 2015, and as such, €6.1 million (US\$8.0 million) is included in other long-term liabilities in the Company's condensed consolidated balance sheet as of May 4, 2013. At February 2, 2013, the Company included €9.1 million (US\$12.4 million) in other long-term liabilities related to this agreement.

The Company has been advised by its Italian counsel that tax audits like this one in Italy involving proposed income adjustments greater than €2 million are automatically referred for review by a public prosecutor who may seek to pursue charges or close the matter, and that resulting criminal charges, if any, would be instituted against individuals rather than against the affected companies under Italian law. Consistent with this process, a review proceeding by a prosecutor in Italy has been initiated with respect to one current and two former members of the Guess European management team and the Company's former President (as the signing officer for certain Italian tax returns covering the relevant periods). The prosecutor has not yet made a final determination regarding this matter.

**(7) Segment Information**

The Company's businesses are grouped into five reportable segments for management and internal financial reporting purposes: North American Retail, Europe, Asia, North American Wholesale and Licensing. Management evaluates segment performance based primarily on revenues and earnings from operations before restructuring charges, if any. The Company believes this segment reporting reflects how its five business segments are managed and each segment's performance is evaluated. The North American Retail segment includes the Company's retail operations in North America. The Europe segment includes the Company's wholesale and retail operations in Europe and the Middle East. The Asia segment includes the Company's wholesale and retail operations in Asia. The North American Wholesale segment includes the Company's wholesale operations in North America and export sales to Central and South America. The Licensing segment includes the worldwide licensing operations of the Company. The business segment operating results exclude corporate overhead costs, which consist of shared costs of the organization. These costs are presented separately and generally include, among other things, the following unallocated corporate costs: accounting and finance, executive compensation, facilities, global advertising and marketing, human resources, information technology and legal.

Net revenue and earnings from operations are summarized as follows for the three months ended May 4, 2013 and April 28, 2012 (in thousands):

|                                  | Three Months Ended |              |
|----------------------------------|--------------------|--------------|
|                                  | May 4, 2013        | Apr 28, 2012 |
| Net revenue:                     |                    |              |
| North American Retail            | \$238,311          | \$251,798    |
| Europe                           | 165,392            | 189,815      |
| Asia                             | 71,132             | 64,835       |
| North American Wholesale         | 43,829             | 43,918       |
| Licensing                        | 30,250             | 28,900       |
| Total net revenue                | \$548,914          | \$579,266    |
| Earnings (loss) from operations: |                    |              |
| North American Retail            | \$(4,233)          | ) \$16,990   |
| Europe                           | (5,218)            | ) 12,481     |
| Asia                             | 6,964              | ) 5,875      |
| North American Wholesale         | 8,649              | ) 9,346      |
| Licensing                        | 26,204             | ) 24,586     |
| Corporate Overhead               | (18,704)           | ) (30,137)   |
| Restructuring Charges            | (2,337)            | ) —          |
| Total earnings from operations   | \$11,325           | ) \$39,141   |

Due to the seasonal nature of the Company's business segments, the above net revenue and operating results are not necessarily indicative of the results that may be expected for the full fiscal year.



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## (8) Borrowings and Capital Lease Obligations

Borrowings and capital lease obligations are summarized as follows (in thousands):

|   | May 4, 2013 | Feb 2, 2013 |
|---|-------------|-------------|
| European capital lease, maturing quarterly through 2016 | \$9,273     | \$10,121    |
| Other   | 217         | 94          |
|   | 9,490       | 10,215      |
| Less current installments                               | 1,931       | 1,901       |
| Long-term capital lease obligations                     | \$7,559     | \$8,314     |
| Capital Lease   |             |             |

The Company entered into a capital lease in December 2005 for a new building in Florence, Italy. At May 4, 2013, the capital lease obligation was \$9.3 million. The Company entered into a separate interest rate swap agreement designated as a non-hedging instrument that resulted in a swap fixed rate of 3.55%. This interest rate swap agreement matures in 2016 and converts the nature of the capital lease obligation from Euribor floating-rate debt to fixed-rate debt. The fair value of the interest rate swap liability at May 4, 2013 was approximately \$0.7 million.

## Credit Facilities

On July 6, 2011, the Company entered into a five-year senior secured revolving credit facility with JPMorgan Chase Bank, N.A., Bank of America, N.A. and the other lenders party thereto (the "Credit Facility") which provided for a \$200 million revolving multicurrency line of credit. The Credit Facility is available for direct borrowings and the issuance of letters of credit, subject to certain letters of credit sublimits. It may be used for working capital and other general corporate purposes.

On August 31, 2012, the Company increased its borrowing capacity under the Credit Facility from \$200 million to \$300 million by exercising the accordion feature in the Credit Facility pursuant to a Lender Joinder Agreement with the lenders party thereto. Also on August 31, 2012, the Company entered into an Amendment to the Credit Facility with the lenders party thereto to provide for (i) greater flexibility in certain of the Company's covenants under the Credit Facility and (ii) access to a new \$100 million accordion feature, subject to certain conditions and the willingness of existing or new lenders to assume such increased amount. At May 4, 2013, the Company had \$3.2 million in outstanding standby letters of credit, no outstanding documentary letters of credit and no outstanding borrowings under the Credit Facility.

The Company, through its European subsidiaries, maintains short-term uncommitted borrowing agreements, primarily for working capital purposes, with various banks in Europe. The majority of the borrowings under these agreements are secured by specific accounts receivable balances. Based on the applicable accounts receivable balances at May 4, 2013, the Company could have borrowed up to \$135.1 million under these agreements. At May 4, 2013, the Company had no outstanding borrowings and \$5.0 million in outstanding documentary letters of credit under these agreements. The agreements are denominated primarily in euros and provide for annual interest rates ranging from 0.5% to 3.0%. The maturities of any short-term borrowings under these arrangements are generally linked to the credit terms of the underlying accounts receivable that secure the borrowings. With the exception of one facility for up to \$45.9 million that has a minimum net equity requirement, there are no other financial ratio covenants.

From time to time, the Company will obtain other short-term financing in foreign countries for working capital to finance its local operations.

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## (9) Share-Based Compensation

The following table summarizes the share-based compensation expense recognized under all of the Company's stock plans during the three months ended May 4, 2013 and April 28, 2012 (in thousands):

|  | Three Months Ended |              |
|--|--------------------|--------------|
|  | May 4, 2013        | Apr 28, 2012 |
| Stock options                          | \$573              | \$1,188      |
| Nonvested stock awards/units           | 1,605              | 3,509        |
| Employee Stock Purchase Plan           | 70                 | 105          |
| Total share-based compensation expense | \$2,248            | \$4,802      |

Unrecognized compensation cost, adjusted for estimated forfeitures, related to nonvested stock options and nonvested stock awards/units totaled approximately \$6.0 million and \$23.2 million, respectively, as of May 4, 2013. This cost is expected to be recognized over a weighted-average period of 1.9 years. The weighted average fair values of stock options granted during the three months ended May 4, 2013 and April 28, 2012 were \$5.92 and \$9.23, respectively.

On April 3, 2013, the Company made an annual grant of 416,500 stock options and 408,400 nonvested stock awards/units to its employees. On March 28, 2012, the Company made an annual grant of 290,400 stock options and 292,800 nonvested stock awards/units to its employees. On June 21, 2012, the Company made a grant of 270,000 nonvested stock awards/units to its employees.

On June 18, 2011, Maurice Marciano, the Company's then-serving executive Chairman of the Board of Directors, notified the Company of his decision to retire as an employee and executive officer effective January 28, 2012, the end of fiscal 2012. Mr. Marciano continues to serve as non-executive Chairman of the Board of Directors. In accordance with the terms of Mr. Marciano's employment agreement, the Company and Mr. Marciano entered into a two-year consulting agreement, under which Mr. Marciano will provide certain consulting services to the Company through January 2014. In connection with the ongoing services to be provided, Mr. Marciano's outstanding equity awards were modified to provide that all awards that would have otherwise been unvested and forfeited at January 28, 2012, will continue to vest in accordance with the original vesting terms for as long as Mr. Marciano continues to serve as a member of the Board of Directors of the Company. The original grant date fair value of the modified equity awards aggregated \$4.7 million while the modified grant date fair value aggregated \$5.0 million. As a result of the modification, compensation expense of \$2.5 million was accelerated and recorded in the last eight months of fiscal 2012.

On May 1, 2008, the Company granted an aggregate of 167,000 nonvested stock awards to certain employees which were subject to certain annual performance-based vesting conditions over a five-year period. On October 30, 2008, the Company granted an aggregate of 563,400 nonvested stock options to certain employees scheduled to vest over a four-year period, which were subject to the achievement of performance-based vesting conditions for fiscal 2010. During the first quarter of fiscal 2010, the Compensation Committee determined that the performance goals established in the prior year were no longer set at an appropriate level to incentivize and help retain employees given the greater than previously anticipated deterioration of the economy that had occurred since the goals were established. Therefore, in April 2009, the Compensation Committee modified the performance goals of that year's tranche of the outstanding performance-based stock awards and options to address the challenges associated with the economic environment. During the first quarter of fiscal 2011, fiscal 2012 and fiscal 2013, the Compensation Committee modified the performance goals of the respective year's tranche of the outstanding performance-based stock awards to address the continuing challenges associated with the economic environment. None of the modifications had a material impact on the consolidated financial statements of the Company.

## (10) Related Party Transactions

The Company and its subsidiaries periodically enter into transactions with other entities or individuals that are considered related parties, including certain transactions with entities affiliated with trusts for the respective

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benefit of Paul Marciano, who is an executive of the Company, Maurice Marciano, Chairman of the Board, Armand Marciano, their brother and former executive of the Company, and certain of their children (the “Marciano Trusts”).

Leases

The Company leases warehouse and administrative facilities, including the Company’s corporate headquarters in Los Angeles, California, from partnerships affiliated with the Marciano Trusts and certain of their affiliates. There were four of these leases in effect at May 4, 2013 with expiration dates ranging from 2014 to 2020.

Aggregate rent and property tax expense under these related party leases was \$1.5 million for each of the three months ended May 4, 2013 and April 28, 2012. The Company believes the related party lease terms have not been significantly affected by the fact that the Company and the lessors are related.

Aircraft Arrangements

The Company periodically charters aircraft owned by MPM Financial, LLC (“MPM Financial”), an entity affiliated with the Marciano Trusts, through independent third party management companies contracted by MPM Financial to manage its aircraft. Under an informal arrangement with MPM Financial and the third party management companies, the Company has chartered, and may from time-to-time continue to charter, aircraft owned by MPM Financial at a discount from the third party management companies’ preferred customer hourly charter rates. The total fees paid under these arrangements for the three months ended May 4, 2013 were minimal. During the three months ended April 28, 2012, the total fees paid under these arrangements were approximately \$0.4 million.

Consulting Arrangement

After serving for over 30 years as an executive and leader for Guess?, co-founder Maurice Marciano elected to retire from his position as executive Chairman of the Board and as an employee of the Company upon the expiration of his employment agreement on January 28, 2012. Mr. Marciano continues to serve the Company as its non-executive Chairman of the Board. In addition, under the terms of his previously existing employment agreement, the Company and Mr. Marciano entered into a two-year consulting agreement (the “Marciano Consulting Agreement”) under which Mr. Marciano will provide certain consulting services to the Company, including advice and counsel to the Company’s Chief Executive Officer and other senior executives. The Marciano Consulting Agreement, which has a two-year term that commenced on January 28, 2012, provides for consulting fees of \$500,000 per year and continued automobile use in a manner consistent with past practice. Total expenses incurred with respect to the Marciano Consulting Agreement were \$0.1 million for each of the three months ended May 4, 2013 and April 28, 2012.

Other Transactions

From time to time, the Company utilizes a third-party agent named Harmony Collection, LLC to produce specific apparel products on behalf of the Company. Armand Marciano, brother of Maurice and Paul Marciano, is part owner and an executive of the parent company of Harmony Collection, LLC. The total payments made by the Company under this arrangement for the three months ended May 4, 2013 and April 28, 2012 were approximately \$0.4 million and \$0.1 million, respectively. The Company believes that the price and transaction terms have not been significantly affected by the relationship between the parties.

These related party disclosures should be read in conjunction with the disclosure concerning related party transactions in the Company’s Annual Report on Form 10-K for the year ended February 2, 2013.

(11) Commitments and Contingencies

Leases

The Company leases its showrooms and retail store locations under operating lease agreements expiring on various dates through September 2031. Some of these leases require the Company to make periodic payments for property taxes, utilities and common area operating expenses. Certain retail store leases provide for rents

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based upon the minimum annual rental amount and a percentage of annual sales volume, generally ranging from 3% to 12%, when specific sales volumes are exceeded. Some leases include lease incentives, rent abatements and fixed rent escalations, which are amortized and recorded over the initial lease term on a straight-line basis. The Company also leases some of its equipment under operating lease agreements expiring at various dates through October 2018. As discussed in further detail in Note 8, the Company leases a building in Florence, Italy under a capital lease.

Litigation

On May 6, 2009, Gucci America, Inc. filed a complaint in the U.S. District Court for the Southern District of New York against Guess?, Inc. and certain third-party licensees for the Company asserting, among other things, trademark and trade dress law violations and unfair competition. The complaint sought injunctive relief, compensatory damages, including treble damages, and certain other relief. Complaints similar to those in the above action have also been filed by Gucci entities against the Company and certain of its subsidiaries in the Court of Milan, Italy, the Court of Paris, France and the Intermediate People's Court of Nanjing, China.

The three week bench trial in the U.S. matter concluded on April 19, 2012, with the court issuing a preliminary ruling on May 21, 2012 and a final ruling on July 19, 2012. Although the plaintiff was seeking compensation in the U.S. matter in the form of damages of \$26 million and an accounting of profits of \$99 million, the final ruling provided for monetary damages of \$2.3 million against the Company and \$2.3 million against certain of its licensees. The court also granted narrow injunctions in favor of the plaintiff for certain of the claimed infringements. On August 20, 2012, the appeal period expired without any party having filed an appeal, rendering the judgment final.

On May 2, 2013, the Court of Milan ruled in favor of the Company in the Milan, Italy matter. In the ruling, the Court rejected all of the plaintiff's claims and ordered the cancellation of three of the plaintiff's Italian and four of the plaintiff's European Community trademark registrations. On June 10, 2013, the plaintiff appealed the Court's ruling in the Milan matter.

Although the Company believes that it has a strong position and will continue to vigorously defend each of these remaining matters (including the appeal of the Milan decision), it is unable to predict with certainty whether or not these efforts will ultimately be successful or whether the outcomes will have a material impact on the Company's financial position or results of operations.

The Company is also involved in various other claims and other matters incidental to the Company's business, the resolution of which is not expected to have a material adverse effect on the Company's financial position or results of operations. No material amounts were accrued as of May 4, 2013 or February 2, 2013 related to any of the Company's legal proceedings.

(12) Supplemental Executive Retirement Plan

The components of net periodic pension cost for the three months ended May 4, 2013 and April 28, 2012 were as follows (in thousands):

|   | Three Months Ended |              |
|---|--------------------|--------------|
|   | May 4, 2013        | Apr 28, 2012 |
| Interest cost                                       | \$586              | \$598        |
| Net amortization of unrecognized prior service cost | 155                | 155          |
| Net amortization of actuarial losses                | 277                | 835          |
| Net periodic defined benefit pension cost           | \$1,018            | \$1,588      |

As a non-qualified pension plan, no dedicated funding of the SERP is required; however, the Company has made, and expects to continue to make, periodic payments into insurance policies held in a rabbi trust to fund the expected obligations arising under the non-qualified SERP. The amount of future payments may vary, depending on current estimates of final annual compensation and investment performance of the trust. The cash surrender values of the insurance policies were \$49.3 million and \$47.9 million as of May 4, 2013 and February 2, 2013,

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respectively, and were included in other assets in the Company's condensed consolidated balance sheets. As a result of changes in the value of the insurance policy investments, the Company recorded unrealized gains of \$1.5 million and \$1.2 million in other income during the three months ended May 4, 2013 and April 28, 2012, respectively.

**(13) Fair Value Measurements**

Authoritative guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The guidance establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1 - Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that can be accessed at the measurement date.

Level 2 - Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (i.e. interest rates, yield curves, etc.), and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

Level 3 - Unobservable inputs that reflect assumptions about what market participants would use in pricing the asset or liability. These inputs would be based on the best information available, including the Company's own data.

The following table presents the fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of May 4, 2013 and February 2, 2013 (in thousands):

| Recurring Fair Value Measures       | Fair Value Measurements at May 4, 2013 |                |            |                 | Fair Value Measurements at Feb 2, 2013 |                 |            |                 |
|-------------------------------------|--|----------------|------------|-----------------|--|-----------------|------------|-----------------|
|                                     | Level 1                                | Level 2        | Level 3    | Total           | Level 1                                | Level 2         | Level 3    | Total           |
| <b>Assets:</b>                      |  |                |            |                 |  |                 |            |                 |
| Foreign exchange currency contracts | \$—                                    | \$3,773        | \$—        | \$3,773         | \$—                                    | \$1,358         | \$—        | \$1,358         |
| Available-for-sale securities       | 12,708                                 | —              | —          | 12,708          | 12,630                                 | —               | —          | 12,630          |
| <b>Total</b>                        | <b>\$12,708</b>                        | <b>\$3,773</b> | <b>\$—</b> | <b>\$16,481</b> | <b>\$12,630</b>                        | <b>\$1,358</b>  | <b>\$—</b> | <b>\$13,988</b> |
| <b>Liabilities:</b>                 |  |                |            |                 |  |                 |            |                 |
| Foreign exchange currency contracts | \$—                                    | \$86           | \$—        | \$86            | \$—                                    | \$5,552         | \$—        | \$5,552         |
| Interest rate swap                  | —                                      | 737            | —          | 737             | —                                      | 852             | —          | 852             |
| Deferred compensation obligations   | —                                      | 7,970          | —          | 7,970           | —                                      | 7,574           | —          | 7,574           |
| <b>Total</b>                        | <b>\$—</b>                             | <b>\$8,793</b> | <b>\$—</b> | <b>\$8,793</b>  | <b>\$—</b>                             | <b>\$13,978</b> | <b>\$—</b> | <b>\$13,978</b> |

There were no transfers of financial instruments between the three levels of fair value hierarchy during the three months ended May 4, 2013 or during the year ended February 2, 2013.

The fair values of the Company's available-for-sale securities are based on quoted prices. The fair value of the interest rate swaps are based upon inputs corroborated by observable market data. Foreign exchange forward contracts are entered into by the Company principally to hedge the future payment of inventory and intercompany transactions by non-U.S. subsidiaries. Periodically, the Company may also use foreign exchange forward contracts to hedge the translation and economic exposures related to its net investments in certain of its international subsidiaries. The fair values of the Company's foreign exchange forward contracts are based on quoted foreign exchange forward rates at the reporting date. Deferred compensation obligations to employees are adjusted based on changes in the fair value of the underlying employee-directed investments. Fair value of these obligations is based upon inputs corroborated by observable market data.

Available-for-sale securities are recorded at fair value and are included in short-term investments and other assets in the accompanying condensed consolidated balance sheets depending on their respective maturity dates. At May 4, 2013, available-for-sale securities consisted of \$10.3 million of corporate bonds with maturity dates ranging from November 2013 to September 2014, \$1.8 million of certificates of deposit which mature in May 2013 and \$0.6 million of marketable equity securities. At February 2, 2013, available-for-sale securities consisted of \$10.3 million of corporate bonds, \$1.8 million of certificates of deposit and \$0.5 million of marketable equity





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securities. Unrealized gains (losses), net of taxes, are included as a component of stockholders' equity and comprehensive income (loss). The accumulated unrealized gains net of taxes, included in accumulated other comprehensive income (loss) related to available-for-sale securities owned by the Company at May 4, 2013 were \$0.2 million. The accumulated unrealized gains, net of taxes, included in accumulated other comprehensive income (loss) related to available-for-sale securities owned by the Company at February 2, 2013 were \$0.1 million.

The carrying amount of the Company's remaining financial instruments, which principally include cash and cash equivalents, trade receivables, accounts payable and accrued expenses, approximates fair value due to the relatively short maturity of such instruments. The fair values of the Company's debt instruments (see Note 8) are based on the amount of future cash flows associated with each instrument discounted using the Company's incremental borrowing rate. At May 4, 2013 and February 2, 2013, the carrying value of all financial instruments was not materially different from fair value, as the interest rates on variable-rate debt including the capital lease obligation approximated rates currently available to the Company.

Long-Lived Assets

Long-lived assets, such as property, plant, and equipment, and purchased intangibles subject to amortization, are reviewed for impairment quarterly or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company considers each individual store as an asset group for impairment testing, which is the lowest level at which individual cash flows can be identified. The asset group includes store leasehold improvements, furniture, fixtures and equipment, computer hardware and software and certain long-term security deposits and lease acquisition costs. The Company reviews retail stores for impairment risk once the locations have been opened for at least one year, or sooner as changes in circumstances require. The Company believes that waiting one year allows a store to reach a maturity level where a more comprehensive analysis of financial performance can be performed.

An asset is considered to be impaired if the Company determines that the carrying value may not be recoverable based upon its assessment of the asset's ability to continue to generate income from operations and positive cash flow in future periods or if significant changes in the Company's strategic business objectives and utilization of the assets occurred. If the carrying amount of an asset exceeds its estimated undiscounted future cash flows, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the estimated fair value, which is determined based on discounted future cash flows. The impairment loss calculations require management to apply judgment in estimating future cash flows and the discount rates that reflect the risk inherent in future cash flows. Future expected cash flows for store assets are based on management's estimates of future cash flows over the remaining lease period or expected life, if shorter. The Company considers historical trends, expected future business trends and other factors when estimating each store's future cash flow. The Company also considers factors such as: the local environment for each store location, including mall traffic and competition; the Company's ability to successfully implement strategic initiatives; and the ability to control variable costs such as cost of sales and payroll, and in some cases, renegotiate lease costs. The estimated cash flows used for this nonrecurring fair value measurement are considered a Level 3 input as defined above. If actual results are not consistent with the assumptions and judgments used in estimating future cash flows and asset fair values, there may be additional exposure to future impairment losses that could be material to the Company's results of operations.

The Company recorded asset impairments charges of \$1.0 million and \$0.1 million during the three months ended May 4, 2013 and April 28, 2012, respectively, related primarily to the impairment of long-lived assets for certain retail stores in North America. These long-lived assets were fully impaired during the respective periods.

(14) Derivative Financial InstrumentsHedging Strategy

The Company operates in foreign countries, which exposes it to market risk associated with foreign currency exchange rate fluctuations. The Company has entered into certain forward contracts to hedge the risk of foreign currency rate fluctuations. The Company has elected to apply the hedge accounting rules in accordance with authoritative guidance for certain of these hedges.



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The Company's primary objective is to hedge the variability in forecasted cash flows due to the foreign currency risk. Various transactions that occur in Canada, Europe and South Korea are denominated in U.S. dollars and British pounds and thus are exposed to earnings risk as a result of exchange rate fluctuations when converted to their functional currencies. These types of transactions include U.S. dollar denominated purchases of merchandise and U.S. dollar and British pound intercompany liabilities. In addition, certain operating expenses and tax liabilities are denominated in Swiss francs and are exposed to earnings risk as a result of exchange rate fluctuations when converted to the functional currency. The Company enters into derivative financial instruments, including forward exchange contracts, to offset some but not all of the exchange risk on certain of these anticipated foreign currency transactions. Periodically, the Company may also use foreign currency forward contracts to hedge the translation and economic exposures related to its net investments in certain of its international subsidiaries.

The impact of the credit risk of the counterparties to the derivative contracts is considered in determining the fair value of the foreign currency forward contracts. As of May 4, 2013, credit risk has not had a significant effect on the fair value of the Company's foreign currency contracts.

The Company also has interest rate swap agreements, which are not designated as hedges for accounting purposes, to effectively convert its floating-rate debt to a fixed-rate basis. The principal objective of these contracts is to eliminate or reduce the variability of the cash flows in interest payments associated with the Company's variable rate capital lease obligation, thus reducing the impact of interest rate changes on future interest payment cash flows. Refer to Note 8 for further information.

**Hedge Accounting Policy**

U.S. dollar forward contracts are used to hedge forecasted merchandise purchases over specific months. Changes in the fair value of these U.S. dollar forward contracts, designated as cash flow hedges, are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are recognized in cost of product sales in the period which approximates the time the hedged merchandise inventory is sold. The Company also hedges forecasted intercompany royalties over specific months. Changes in the fair value of these U.S. dollar forward contracts, designated as cash flow hedges, are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are recognized in other income and expense in the period in which the royalty expense is incurred.

U.S. dollar forward contracts are also used to hedge the net investments of certain of the Company's international subsidiaries over specific months. Changes in the fair value of these U.S. dollar forward contracts, designated as net investment hedges, are recorded in foreign currency translation adjustment as a component of accumulated other comprehensive income (loss) within stockholders' equity and are not recognized in income until the sale or liquidation of the hedged net investment.

The Company also has foreign currency contracts that are not designated as hedging instruments for accounting purposes. Changes in fair value of foreign currency contracts not qualifying as cash flow hedges or net investment hedges are reported in net earnings as part of other income and expense.

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## Summary of Derivative Instruments

The fair value of derivative instruments in the condensed consolidated balance sheet as of May 4, 2013 and February 2, 2013 was as follows (in thousands):

|   | Derivative<br>Balance Sheet<br>Location | Fair Value at<br>May 4,<br>2013 | Fair Value at<br>Feb 2,<br>2013 |
|---|---|---------------------------------|---------------------------------|
| <b>ASSETS:</b>                                      |   |                                 |                                 |
| Derivatives designated as hedging instruments:      |   |                                 |                                 |
| Foreign exchange currency contracts:                |   |                                 |                                 |
| Cash flow hedges                                    | Other current assets                    | \$1,940                         | \$387                           |
| Derivatives not designated as hedging instruments:  |   |                                 |                                 |
| Foreign exchange currency contracts                 | Other current assets                    | 1,833                           | 971                             |
| Total   |   | \$3,773                         | \$1,358                         |
| <b>LIABILITIES:</b>                                 |   |                                 |                                 |
| Derivatives designated as hedging instruments:      |   |                                 |                                 |
| Foreign exchange currency contracts:                |   |                                 |                                 |
| Cash flow hedges                                    | Current liabilities                     | \$34                            | \$2,904                         |
| Net investment hedges                               | Current liabilities                     | 23                              | —                               |
| Total derivatives designated as hedging instruments |   | 57                              |                                 |