BIG 5 SPORTING GOODS CORP
Form 10-Q
August 06, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 4, 2010

OR

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

For the transition period from __________ to __________

Commission file number: 000-49850

BIG 5 SPORTING GOODS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	95-4388794
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
2525 East El Segundo Boulevard El Segundo, California	90245
(Address of Principal Executive Offices)	(Zip Code)

Registrant s telephone number, including area code: (310) 536-0611

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

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 o No o

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	o	Accelerated filer	þ
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

There were 21,813,662 shares of common stock, with a par value of $0.01 per share outstanding as of August 1, 2010.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

BIG 5 SPORTING GOODS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	July 4, 2010	January 3, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,581	$ 5,765
Accounts receivable, net of allowances of $80 and $223, respectively	12,005	13,398
Merchandise inventories, net	252,040	230,911
Prepaid expenses	10,360	9,683
Deferred income taxes	7,616	7,723
Total current assets	287,602	267,480
Property and equipment, net	78,377	81,817
Deferred income taxes	13,195	11,327
Other assets, net of accumulated amortization of $372 and $346, respectively	1,091	1,065
Goodwill	4,433	4,433
Total assets	$ 384,698	$ 366,122
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 96,143	$ 85,721
Accrued expenses	49,490	59,314
Current portion of capital lease obligations	1,895	1,904
Short-term revolving credit borrowings	64,083	
Total current liabilities	211,611	146,939
Deferred rent, less current portion	23,544	23,832
Capital lease obligations, less current portion	1,652	2,278
Long-term revolving credit borrowings		54,955
Other long-term liabilities	6,712	6,257
Total liabilities	243,519	234,261
Commitments and contingencies		
Stockholders equity:		
Common stock, $0.01 par value, authorized 50,000,000 shares; issued 23,295,712 and 23,050,061 shares, respectively; outstanding 21,812,417 and 21,566,766 shares, respectively	233	230
Additional paid-in capital	96,958	95,259

Retained earnings	65,354	57,738
Less: Treasury stock, at cost; 1,483,295 shares	(21,366)	(21,366)
Total stockholders equity	141,179	131,861
Total liabilities and stockholders equity	$ 384,698	$ 366,122

See accompanying notes to unaudited condensed consolidated financial statements.

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BIG 5 SPORTING GOODS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	13 Weeks Ended		26 Weeks Ended	
	July 4, 2010	**June 28, 2009**	**July 4, 2010**	**June 28, 2009**
Net sales	$ 219,828	$ 216,040	$ 438,349	$ 426,331
Cost of sales	146,862	144,709	293,833	287,929
Gross profit	72,966	71,331	144,516	138,402
Selling and administrative expense	65,002	63,029	128,065	124,867
Operating income	7,964	8,302	16,451	13,535
Interest expense	363	608	767	1,321
Income before income taxes	7,601	7,694	15,684	12,214
Income taxes	2,849	3,039	5,899	4,800
Net income	$ 4,752	$ 4,655	$ 9,785	$ 7,414
Earnings per share:				
Basic	$ 0.22	$ 0.22	$ 0.45	$ 0.35
Diluted	$ 0.22	$ 0.22	$ 0.45	$ 0.35
Dividends per share	$ 0.05	$ 0.05	$ 0.10	$ 0.10
Weighted-average shares of common stock outstanding:				
Basic	21,554	21,429	21,519	21,422
Diluted	21,893	21,554	21,873	21,483

See accompanying notes to unaudited condensed consolidated financial statements.

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BIG 5 SPORTING GOODS CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	26 Weeks Ended	
	July 4, 2010	**June 28, 2009**
Cash flows from operating activities:		
Net income	$ 9,785	$ 7,414
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	9,407	9,716
Share-based compensation	940	1,031
Excess tax benefit related to share-based awards	(290)	
Amortization of deferred finance charges	26	27
Deferred income taxes	(1,761)	674
Loss (gain) on disposal of property and equipment	18	(11)
Changes in operating assets and liabilities:		
Accounts receivable, net	1,393	7,921
Merchandise inventories, net	(21,129)	(8,194)
Prepaid expenses and other assets	(729)	(2,257)
Accounts payable	12,691	20,181
Accrued expenses and other long-term liabilities	(9,929)	(7,968)
Net cash provided by operating activities	422	28,534
Cash flows from investing activities:		
Purchases of property and equipment	(4,987)	(2,198)
Proceeds from disposal of property and equipment	4	
Net cash used in investing activities	(4,983)	(2,198)
Cash flows from financing activities:		
Net borrowings (payments) under revolving credit facility and book overdraft	6,804	(28,648)
Principal payments under capital lease obligations	(1,021)	(1,206)
Proceeds from exercise of stock options	614	8
Excess tax benefit related to share-based awards	290	
Tax withholding payments for share-based compensation	(143)	(47)
Dividends paid	(2,167)	(2,150)
Net cash provided by (used in) financing activities	4,377	(32,043)
Net decrease in cash and cash equivalents	(184)	(5,707)
Cash and cash equivalents at beginning of period	5,765	9,058
Cash and cash equivalents at end of period	$ 5,581	$ 3,351

Supplemental disclosures of non-cash investing and financing activities:

Property and equipment acquired under capital leases	$	405	$	1,341
Property and equipment purchases accrued	$	911	$	457
Stock awards vested and issued to employees	$	456	$	182
Supplemental disclosures of cash flow information:				
Interest paid	$	749	$	1,443
Income taxes paid	$	7,365	$	296

See accompanying notes to unaudited condensed consolidated financial statements.

BIG 5 SPORTING GOODS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Description of Business

Business

Big 5 Sporting Goods Corporation (the Company) is a leading sporting goods retailer in the western United States, operating 388 stores in 12 states at July 4, 2010. The Company provides a full-line product offering in a traditional sporting goods store format that averages approximately 11,000 square feet. The Company s product mix includes athletic shoes, apparel and accessories, as well as a broad selection of outdoor and athletic equipment for team sports, fitness, camping, hunting, fishing, tennis, golf, snowboarding and in-line skating. The Company is a holding company that operates as one business segment through Big 5 Corp., its wholly-owned subsidiary, and Big 5 Services Corp., which is a wholly-owned subsidiary of Big 5 Corp. Big 5 Services Corp. provides a centralized operation for the issuance and administration of gift cards.

The accompanying interim unaudited condensed consolidated financial statements (Interim Financial Statements) of the Company and its wholly-owned subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and are presented in accordance with the requirements of Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, these Interim Financial Statements do not include all of the information and notes required by GAAP for complete financial statements. These Interim Financial Statements should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended January 3, 2010 included in the Company s Annual Report on Form 10-K/A. In the opinion of management, the Interim Financial Statements included herein contain all adjustments, including normal recurring adjustments, considered necessary to present fairly the Company s financial position, the results of operations and cash flows for the periods presented.

The operating results and cash flows of the interim periods presented herein are not necessarily indicative of the results to be expected for any other interim period or the full year.

(2) Summary of Significant Accounting Policies

Consolidation

The accompanying Interim Financial Statements include the accounts of Big 5 Sporting Goods Corporation, Big 5 Corp. and Big 5 Services Corp. Intercompany balances and transactions have been eliminated in consolidation.

Reporting Period

The Company follows the concept of a 52-53 week fiscal year, which ends on the Sunday nearest December 31. Fiscal year 2010 is comprised of 52 weeks and ends on January 2, 2011. Fiscal year 2009 was comprised of 53 weeks and ended on January 3, 2010. The four quarters in fiscal 2010 are each comprised of 13 weeks, while the first three quarters in fiscal 2009 were each comprised of 13 weeks, and the fourth quarter of fiscal 2009 was comprised of 14 weeks.

BIG 5 SPORTING GOODS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Recently Issued Accounting Updates

In May 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) 855, *Subsequent Events*, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, ASC 855 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. In February 2010, Accounting Standards Update (ASU) 2010-09, *Amendments to Certain Recognition and Disclosure Requirements*, was issued to clarify certain questions that arose in practice. ASU 2010-09 amended ASC 855 to, among other things, expressly require Securities and Exchange Commission (SEC) filers to evaluate subsequent events through the date the financial statements are issued. ASC 855 was effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively, while ASU 2010-09 was effective upon issuance. Accordingly, the Company adopted ASC 855 in the second quarter of fiscal 2009 and ASU 2010-09 in February 2010. The adoption of ASC 855 and ASU 2010-09 had no impact on the Company s Interim Financial Statements.

Use of Estimates

Management 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 Interim Financial Statements and reported amounts of revenue and expense during the reporting period to prepare these Interim Financial Statements in conformity with GAAP. Certain items subject to such estimates and assumptions include the carrying amount of property and equipment, and goodwill; valuation allowances for receivables, sales returns, inventories and deferred income tax assets; estimates related to gift card breakage and the valuation of share-based payment awards; and obligations related to asset retirements, litigation, self-insurance liabilities and employee benefits. Actual results could differ significantly from these estimates under different assumptions and conditions.

Revenue Recognition

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

Cash received from the sale of gift cards is recorded as a liability, and revenue is recognized upon the redemption of the gift card or when it is determined that the likelihood of redemption is remote (gift card breakage) and no liability to relevant jurisdictions exists. The Company determines the gift card breakage rate based upon historical redemption patterns and

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BIG 5 SPORTING GOODS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(continued)

recognizes gift card breakage on a straight-line basis over the estimated gift card redemption period (20 quarters as of the end of the second quarter of fiscal 2010). The Company recognized approximately $108,000 and $217,000 in gift card breakage revenue for the 13 weeks and 26 weeks ended July 4, 2010, respectively, compared to approximately $115,000 and $231,000 for the 13 weeks and 26 weeks ended June 28, 2009, respectively.

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

Included in revenue are sales of returned merchandise to vendors specializing in the resale of defective or used products, which accounted for less than 1% of net sales in each of the periods reported.

Valuation of Merchandise Inventories

The Company s merchandise inventories are made up of finished goods and are valued at the lower of cost or market using the weighted-average cost method that approximates the first-in, first-out (FIFO) method. Average cost includes the direct purchase price of merchandise inventory, net of vendor allowances and cash discounts, and allocated overhead costs associated with the Company s distribution center.

Management regularly reviews inventories and records valuation reserves for merchandise damage and defective returns, merchandise items with slow-moving or obsolescence exposure and merchandise that has a carrying value that exceeds market value. Because of its merchandise mix, the Company has not historically experienced significant occurrences of obsolescence.

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

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

Leases and Deferred Rent

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

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

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

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

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

(3) Fair Value Measurements

The carrying value of cash, accounts receivable, accounts payable and accrued expenses approximate the fair values of these instruments due to their short-term nature. The carrying amount for borrowings under the Company s financing agreement approximates fair value because of the variable market interest rate charged to the Company for these borrowings.

(4) Accrued Expenses

Accrued expenses consist of the following:

	July 4, 2010	January 3, 2010
	(In thousands)	
Payroll and related expense	$ 16,918	$ 18,472
Occupancy costs	7,527	7,634
Sales tax	6,210	10,379
Advertising	4,646	6,202
Other	14,189	16,627
Accrued expenses	$ 49,490	$ 59,314

(5) Revolving Credit Borrowings

The Company s existing financing agreement with the CIT Group/Business Credit, Inc. (CIT) and a syndicate of other lenders, as amended, originally provided for a line of credit up to $175.0 million. In the second quarter of fiscal 2010, the Company elected to permanently reduce the line of credit available under the existing financing agreement to $140.0 million as a cost saving measure.

During the second half of fiscal 2010, the Company intends to negotiate a new revolving credit financing agreement to replace the existing financing agreement which has an initial termination date of March 20, 2011. Accordingly, as of July 4, 2010, outstanding debt associated with the existing revolving credit facility was classified as a current liability. The Company had

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short-term revolving credit borrowings of $64.1 million as of July 4, 2010, compared to long-term revolving credit borrowings of $55.0 million as of January 3, 2010.

As of July 4, 2010 and January 3, 2010, the Company had a total remaining borrowing capacity under the existing revolving credit facility, after subtracting letters of credit, of $72.5 million and $94.3 million, respectively.

(6) Income Taxes

Under the asset and liability method prescribed under ASC 740, *Income Taxes*, the Company recognizes deferred tax assets and liabilities for the future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized or settled. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date. The realizability of deferred tax assets is assessed throughout the year and a valuation allowance is recorded if necessary to reduce net deferred tax assets to the amount more likely than not to be realized.

The Company files a consolidated federal income tax return and files tax returns in various state and local jurisdictions. The statutes of limitations for consolidated federal income tax returns are open for years 2006 and after, and state and local income tax returns are open for years 2005 and after.

At July 4, 2010 and January 3, 2010, the Company had no unrecognized tax benefits that, if recognized, would affect the Company s effective income tax rate over the next 12 months. The Company s policy is to recognize interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expense. At July 4, 2010 and January 3, 2010, the Company had no accrued interest or penalties.

(7) Share-based Compensation

At its discretion, the Company grants share option awards or nonvested share awards to certain employees, as defined by ASC 718, *Compensation Stock Compensation*, under the Company s 2007 Equity and Performance Incentive Plan (the Plan) and accounts for its share-based compensation in accordance with ASC 718. The Company recognized approximately $0.5 million and $0.9 million in share-based compensation expense, including share option awards and nonvested share awards, for the 13 weeks and 26 weeks ended July 4, 2010, respectively, compared to $0.5 million and $1.0 million for the 13 weeks and 26 weeks ended June 28, 2009, respectively.

Share Option Awards

Share option awards granted by the Company generally vest and become exercisable at the rate of 25% per year with a maximum life of ten years. The exercise price of the share option

BIG 5 SPORTING GOODS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(continued)

awards is equal to the quoted market price of the Company s common stock on the date of grant. In the 26 weeks ended July 4, 2010, the Company granted 12,000 share option awards. The weighted-average grant-date fair value per option for share option awards granted in the 26 weeks ended July 4, 2010 and June 28, 2009 was $6.26 and $1.92, respectively.

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

	13 Weeks Ended		26 Weeks Ended	
	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
Risk-free interest rate	2.4%	3.3%	2.4%	2.3%
Expected term	6.50 years	6.50 years	6.50 years	6.50 years
Expected volatility	55.2%	55.2%	55.2%	55.2%
Expected dividend yield	1.54%	1.52%	1.54%	4.07%

The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected term of the share option award; the expected term represents the weighted-average period of time that share option awards granted are expected to be outstanding giving consideration to vesting schedules and historical participant exercise behavior; the expected volatility is based upon historical volatility of the Company s common stock; and the expected dividend yield is based upon the Company s current dividend rate and future expectations.

As of July 4, 2010, there was $1.3 million of total unrecognized compensation cost related to nonvested share option awards granted. That cost is expected to be recognized over a weighted-average period of 2.4 years.

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BIG 5 SPORTING GOODS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Nonvested Share Awards

In the 26 weeks ended July 4, 2010, the Company granted 172,000 nonvested share awards. The weighted-average grant-date fair value per share of the Company s nonvested share awards granted in the 26 weeks ended July 4, 2010 and June 28, 2009 was $15.52 and $13.17, respectively.

The following table details the Company s nonvested share awards activity for the 26 weeks ended July 4, 2010:

	Shares	Weighted-Average Grant-Date Fair Value
Balance at January 3, 2010	92,925	$ 8.60
Granted	172,000	15.52
Vested	(29,875)	8.45
Forfeited	(300)	7.91
Balance at July 4, 2010	234,750	$ 13.69

The weighted-average grant-date fair value of nonvested share awards is the quoted market price of the Company s common stock on the date of grant, as shown in the table above.

Nonvested share awards granted by the Company vest from the date of grant in four equal annual installments of 25% per year.

As of July 4, 2010, there was $2.9 million of total unrecognized compensation cost related to nonvested share awards. That cost is expected to be recognized over a weighted-average period of 3.2 years.

To satisfy employee minimum statutory tax withholding requirements for nonvested share awards that vest, the Company withholds and retires a portion of the vesting common shares, unless an employee elects to pay cash. In the 26 weeks ended July 4, 2010, the Company withheld 9,104 common shares with a total value of $143,000. This amount is presented as a cash outflow from financing activities in the accompanying interim unaudited condensed consolidated statements of cash flows.

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BIG 5 SPORTING GOODS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(continued)

(8) Earnings Per Share

The Company calculates earnings per share in accordance with ASC 260, *Earnings Per Share*, which requires a dual presentation of basic and diluted earnings per share. Basic earnings per share is calculated by dividing net income by the weighted-average shares of common stock outstanding, reduced by shares repurchased and held in treasury, during the period. Diluted earnings per share represents basic earnings per share adjusted to include the potentially dilutive effect of outstanding share option awards and nonvested share awards.

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

	13 Weeks Ended		26 Weeks Ended	
	July 4, 2010	June 28, 2009	July 4, 2010	June 28, 2009
	(In thousands, except per share amounts)			
Net income	$ 4,752	$ 4,655	$ 9,785	$ 7,414
Weighted-average shares of common stock outstanding:				
Basic	21,554	21,429	21,519	21,422
Dilutive effect of common stock equivalents arising from stock options and nonvested stock awards	339	125	354	61
Diluted	21,893	21,554	21,873	21,483
Basic earnings per share	$ 0.22	$ 0.22	$ 0.45	$ 0.35