Zumiez Inc
Form 10-Q
September 01, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

JULY 30, 2011 FOR THE QUARTERLY PERIOD ENDED JULY 30, 2011

OR

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

Commission file number 000-51300

ZUMIEZ INC.

(Exact name of registrant as specified in its charter)

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

6300 Merrill Creek Parkway, Suite B, Everett, WA 98203

(Address of principal executive offices) (Zip Code)

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

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

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 x 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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

At August 26, 2011, there were 31,108,280 shares outstanding of common stock.

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ZUMIEZ INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	July 30, 2011 (Unaudited)	January 29, 2011
Assets		
Current assets		
Cash and cash equivalents	$ 14,157	$ 11,357
Marketable securities	117,744	117,444
Receivables	10,690	6,129
Income taxes receivable	1,894	
Inventories	84,394	56,303
Prepaid expenses and other	7,669	7,210
Deferred tax assets	2,328	2,418
Total current assets	238,876	200,861
Fixed assets, net	83,713	78,248
Goodwill and other intangibles	13,154	13,154
Long-term deferred tax assets	4,211	5,703
Long-term investments	2,808	2,766
Long-term other assets	605	899
Total long-term assets	104,491	100,770
Total assets	$ 343,367	$ 301,631
Liabilities and Shareholders Equity		
Current liabilities		
Trade accounts payable	$ 50,657	$ 16,371
Accrued payroll and payroll taxes	6,074	7,580
Income taxes payable		4,108
Deferred rent and tenant allowances	4,138	3,719
Other liabilities	12,611	13,683
Total current liabilities	73,480	45,461
Long-term deferred rent and tenant allowances	31,501	27,629
Long-term other liabilities	1,899	1,806
Total long-term liabilities	33,400	29,435
Total liabilities	106,880	74,896
Commitments and contingencies (Note 4)		
Shareholders equity		
Preferred stock, no par value, 20,000 shares authorized; none issued and outstanding		
Common stock, no par value, 50,000 shares authorized; 31,094 shares issued and outstanding at July 30, 2011 and 30,835 shares issued and outstanding at January 29, 2011	96,468	91,373
Accumulated other comprehensive income (loss)	163	(17)
Retained earnings	139,856	135,379
Total shareholders equity	236,487	226,735

Total liabilities and shareholders equity	$	343,367	$	301,631

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 30, 2011	**July 31, 2010**	**July 30, 2011**	**July 31, 2010**
Net sales	$ 112,213	$ 97,702	$ 218,064	$ 186,798
Cost of goods sold	74,916	67,203	147,345	130,801
Gross profit	37,297	30,499	70,719	55,997
Selling, general and administrative expenses	33,747	32,867	64,617	61,619
Operating profit (loss)	3,550	(2,368)	6,102	(5,622)
Interest income, net	434	352	947	717
Other income, net	3	47	58	71
Earnings (loss) before income taxes	3,987	(1,969)	7,107	(4,834)
Provision (benefit) for income taxes	1,396	(755)	2,630	(1,720)
Net income (loss)	$ 2,591	$ (1,214)	$ 4,477	$ (3,114)
Basic earnings (loss) per share	$ 0.08	$ (0.04)	$ 0.15	$ (0.10)
Diluted earnings (loss) per share	$ 0.08	$ (0.04)	$ 0.14	$ (0.10)
Weighted average shares used in computation of earnings (loss) per share:				
Basic	30,521	29,954	30,432	29,846
Diluted	31,081	29,954	31,072	29,846

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(In thousands)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance at January 29, 2011	30,835	$ 91,373	$ (17)	$ 135,379	$ 226,735
Net income				4,477	4,477
Change in unrealized gain or loss on available-for-sale investments, net of tax of $71			111		111
Foreign currency translation, net of tax of $			69		69
Comprehensive income					4,657
Issuance and exercise of stock-based compensation, including tax benefit of $1,658	259	2,323			2,323
Stock-based compensation expense		2,772			2,772
Balance at July 30, 2011	31,094	$ 96,468	$ 163	$ 139,856	$ 236,487

	Common Stock Shares	Common Stock Amount	Accumulated Other Comprehensive Income	Retained Earnings	Total
Balance at January 30, 2010	30,251	$ 81,399	$ 101	$ 111,176	$ 192,676
Net loss				(3,114)	(3,114)
Change in unrealized gain or loss on available-for-sale investments, net of tax of $57			(89)		(89)
Comprehensive loss					(3,203)
Issuance and exercise of stock-based compensation, including tax benefit of $1,602	349	2,446			2,446
Stock-based compensation expense		2,500			2,500
Balance at July 31, 2010	30,600	$ 86,345	$ 12	$ 108,062	$ 194,419

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended July 30, 2011	Six Months Ended July 31, 2010
Cash flows from operating activities:		
Net income (loss)	$ 4,477	$ (3,114)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, amortization and accretion	9,574	9,117
Deferred taxes	1,511	(1,299)
Stock-based compensation expense	2,772	2,500
Loss on disposal of assets	1	262
Excess tax benefit from stock-based compensation	(1,658)	(1,602)
Other	(79)	(9)
Changes in operating assets and liabilities:		
Receivables	(4,215)	(2,693)
Inventories	(28,073)	(27,775)
Prepaid expenses and other	(413)	(1,673)
Trade accounts payable	34,267	31,510
Accrued payroll and payroll taxes	(1,506)	(1,021)
Income taxes payable	(4,674)	(5,392)
Deferred rent and tenant allowances	4,341	2,037
Other liabilities	(1,138)	3,561
Net cash provided by operating activities	15,187	4,409
Cash flows from investing activities:		
Additions to fixed assets	(13,884)	(20,668)
Purchases of marketable securities and other investments	(72,572)	(49,886)
Sales and maturities of marketable securities and other investments	71,358	68,973
Net cash used in investing activities	(15,098)	(1,581)
Cash flows from financing activities:		
Proceeds from exercise of stock-based compensation, net of withholding tax payments	996	844
Excess tax benefit from stock-based compensation	1,658	1,602
Net cash provided by financing activities	2,654	2,446
Effect of exchange rate changes on cash and cash equivalents	57	
Net increase in cash and cash equivalents	2,800	5,274
Cash and cash equivalents, beginning of period	11,357	1,568
Cash and cash equivalents, end of period	$ 14,157	$ 6,842
Supplemental disclosure on cash flow information:		
Cash paid during the period for income taxes	5,789	4,972

See accompanying notes to condensed consolidated financial statements

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ZUMIEZ INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Business and Basis of Presentation

Nature of Business Zumiez Inc. (the Company, we, us, its and our) is a leading specialty retailer of action sports related apparel, footwear, equipment and accessories operating under the Zumiez brand name. At July 30, 2011, we operated 424 stores primarily located in shopping malls, giving us a presence in 38 states and Canada. Our stores cater to young men and women between the ages of 12 and 24 who seek popular brands representing a lifestyle centered on activities that include skateboarding, surfing, snowboarding, bicycle motocross (or BMX) and motocross. We support the action sports lifestyle and promote our brand through a multi-faceted marketing approach that is designed to integrate our brand image with our customers activities and interests. In addition, we operate a website that sells merchandise online and provides content and a community for our target customers. The Company was formed in August 1978 and its home office is located in Everett, Washington. The Company operates within one reportable segment based on the similar nature of products sold, production, merchandising and distribution processes involved, target customers and economic characteristics.

Fiscal Year We use a fiscal calendar widely used by the retail industry that results in a fiscal year consisting of a 52- or 53-week period ending on the Saturday closest to January 31. Each fiscal year consists of four 13-week quarters, with an extra week added to the fourth quarter every five or six years. Fiscal 2011 is the 52-week period ending January 28, 2012. Fiscal 2010 was the 52-week period ending January 29, 2011. The first six months of fiscal 2011 was the 26-week period ended July 30, 2011. The first six months of fiscal 2010 was the 26-week period ended July 31, 2010.

Basis of Presentation The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of Zumiez Inc. and its wholly-owned subsidiaries. All significant intercompany transactions and balances are eliminated in consolidation.

In our opinion, the unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the condensed consolidated balance sheet at July 30, 2011, the condensed consolidated statements of operations for the three and six months ended July 30, 2011 and July 31, 2010, the condensed consolidated statements of changes in shareholders equity for the six months ended July 30, 2011 and July 31, 2010 and the condensed consolidated statements of cash flows for the six months ended July 30, 2011 and July 31, 2010.

The financial data at January 29, 2011 is derived from audited financial statements, which are included in our Annual Report on Form 10-K for the year ended January 29, 2011, and should be read in conjunction with the audited financial statements and notes thereto. Interim results are not necessarily indicative of results for the full fiscal year due to seasonal and other factors.

Use of Estimates The preparation of financial statements in conformity with GAAP requires estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements as well as the reported amounts of revenues and expenses during the reporting period. These estimates can also affect supplemental information disclosed by us, including information about contingencies, risk and financial condition. Actual results could differ from these estimates and assumptions.

Reclassification of Previously Issued Financial Statements Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications do not have a material impact on our condensed consolidated financial statements. We have reclassified $0.2 million and $0.5 million on the condensed consolidated statements of operations for the three and six months ended July 31, 2010 from selling, general and administrative expenses to cost of goods sold related to occupancy, fulfillment and warehousing costs associated with our ecommerce business. We have reclassified these expenses to align the classification of our ecommerce business expenses with the classification of other occupancy, distribution and warehousing costs in cost of goods sold.

2. Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued guidance that requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders equity. This guidance is effective for interim and annual reporting periods beginning after December 15, 2011. We are currently evaluating the guidance and have not yet determined the impact the adoption will have on our condensed consolidated financial statements.

In May 2011, the FASB issued guidance that amends certain accounting and disclosure requirements related to fair value measurements. This guidance is effective for interim and annual reporting periods beginning after December 15, 2011. We are currently evaluating the guidance and have not yet determined the impact the adoption will have on our condensed consolidated financial statements.

In January 2010, the FASB issued guidance that requires reporting entities to make new disclosures about fair value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements and information on purchases, sales, issuances and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. In addition, the guidance clarifies certain existing disclosure requirements. This guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the additional Level 3 reconciliation disclosures, which are effective for interim and annual reporting periods beginning after December 15, 2010. We adopted the additional Level 3 reconciliation disclosure requirements in the three months ended April 30, 2011. The adoption of this guidance did not have a material impact on our condensed consolidated financial statements.

3. Cash, Cash Equivalents and Marketable Securities

The following tables summarize the estimated fair value of our cash, cash equivalents and marketable securities and the gross unrealized holding gains and losses at July 30, 2011 and January 29, 2011 (in thousands):

	July 30, 2011			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	$ 8,430	$	$	$ 8,430
Money market funds	5,727			5,727
State and local government securities				
Total cash and cash equivalents	14,157			14,157
Marketable securities:				
Treasury and agency securities	3,001	10		3,011
State and local government securities	108,147	275	(130)	108,292
Variable-rate demand notes	7,325			7,325
Total marketable securities	$ 118,473	$ 285	$ (130)	$ 118,628
Less: Long-term marketable securities (1)				(884)
Total current marketable securities				$ 117,744

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	January 29, 2011			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Estimated Fair Value
Cash and cash equivalents:				
Cash	$ 7,160	$	$	$ 7,160
Money market funds	928			928
State and local government securities	3,269			3,269
Total cash and cash equivalents	11,357			11,357
Marketable securities:				
Treasury and agency securities	6,043	26		6,069
State and local government securities	103,110	125	(195)	103,040
Variable-rate demand notes	9,205			9,205
Total marketable securities	$ 118,358	$ 151	$ (195)	$ 118,314
Less: Long-term marketable securities (1)				(870)
Total current marketable securities				$ 117,444

(1) At July 30, 2011 and January 29, 2011, we held one $1.0 million par value auction rate security valued at $0.9 million, net of a $0.1 million temporary impairment charge, classified as available-for-sale marketable securities and included in long-term investments on the condensed consolidated balance sheets.

All of our available-for-sale securities, excluding our auction rate security, have an effective maturity of two years or less and may be liquidated, at our discretion, prior to maturity. For the three and six months ended July 30, 2011 and July 31, 2010, realized gains and losses on sales of available-for-sale marketable securities were not material. We use the specific identification method to determine any realized gains or losses from the sale of our marketable securities classified as available-for-sale.

The following tables summarize the gross unrealized holding losses and fair value for investments in an unrealized loss position at July 30, 2011 and January 29, 2011, and the length of time that individual securities have been in a continuous loss position (in thousands):

	July 30, 2011					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Marketable securities:						
Treasury and agency securities	$	$	$	$	$	$
State and local government securities	19,996	(14)	884	(116)	20,880	(130)
Variable-rate demand notes						
Total marketable securities	$ 19,996	$ (14)	$ 884	$ (116)	$ 20,880	$ (130)

	January 29, 2011					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Marketable securities:						
Treasury and agency securities	$	$	$	$	$	$
State and local government securities	42,761	(62)	1,907	(133)	44,668	(195)
Variable-rate demand notes						
Total marketable securities	$ 42,761	$ (62)	$ 1,907	$ (133)	$ 44,668	$ (195)

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We did not record a realized loss for other-than-temporary impairments during the three and six months ended July 30, 2011 and July 31, 2010. At July 30, 2011 and January 29, 2011, we had $0.9 million invested, net of temporary impairment charge of $0.1 million, in an auction rate security that is classified as available-for-sale marketable securities in long-term investments on the condensed consolidated balance sheets. Auction rate securities are generally long-term debt instruments that provide liquidity through a Dutch auction process that resets the applicable interest rate at pre-determined calendar intervals. This mechanism generally allows existing investors to rollover their holdings and continue to own their respective securities or liquidate their holdings by selling their securities at par value. Prior to February 3, 2008, we invested in these securities for short periods of time as part of our cash management program. However, the uncertainties in the credit markets that began in early 2008 have prevented us and other investors from liquidating holdings of auction rate securities in recent auctions for these securities because the amount of securities submitted for sale has exceeded the amount of purchase orders. Should the auction continue to fail, we do not intend to sell the security and it is not more likely than not that we will be required to sell the investment before the liquidity in the market improves. Additionally, the investment is fully collateralized by the U. S. government. Although we are uncertain as to when the liquidity issues relating to this investment will improve, we consider the issue temporary. As a result of the temporary decline in fair value for our auction rate security, we have recorded an unrealized loss of $0.1 million, which is included in accumulated other comprehensive income (loss) on the condensed consolidated balance sheets at July 30, 2011 and January 29, 2011. We continue to monitor the market for auction rate securities and consider its impact, if any, on the fair market value of the investment. It is possible that further declines in fair value may occur, and those declines, if any, would be recognized in accordance with GAAP, and if it is later determined that the fair value of this security is other-than-temporarily impaired, we will record a loss in the condensed consolidated statement of operations. Due to our belief that the market for this investment may take in excess of twelve months to fully recover, we have classified it as a noncurrent asset in long-term investments on the condensed consolidated balance sheets at July 30, 2011 and January 29, 2011.

4. Commitments and Contingencies

Leases We are committed under operating leases for all of our retail store locations and our current combined home office and ecommerce fulfillment center generally with terms of five to ten years. Total rent expense, base rent expense and contingent and other rent expense for the three and six months ended July 30, 2011 and July 31, 2010 is as follows (in thousands). Included in other rent expense are payments of real estate taxes, insurance and common area maintenance costs.

	Three Months Ended		Six Months Ended	
	July 30, 2011	July 31, 2010	July 30, 2011	July 31, 2010
Base rent expense	$ 10,397	$ 9,236	$ 20,265	$ 18,297
Contingent and other rent expense	6,287	5,893	12,403	11,615
Total rent expense	$ 16,684	$ 15,129	$ 32,668	$ 29,912

At July 30, 2011, we were committed to property owners for operating lease obligations for $389.2 million. A majority of our leases provide for ongoing co-tenancy requirements or early cancellation clauses that would further lower rental rates, or permit lease terminations, or both, in the event that co-tenants cease to operate for specific periods or if certain sales levels are not met in specific periods. Most of the store leases require payment of a specified minimum rent and contingent rent based on a percentage of the store s net sales in excess of a specified threshold. Amounts in the table below do not include contingent rent, real estate taxes, insurance or common area maintenance costs unless these costs are fixed and determinable. Future minimum commitments on all leases at July 30, 2011 are as follows (in thousands):

	Operating Lease Obligations
Fiscal 2011	$ 25,580
Fiscal 2012	52,233
Fiscal 2013	52,680
Fiscal 2014	51,056
Fiscal 2015	48,568
Thereafter	159,091
Total	$ 389,208

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Purchase Commitments At July 30, 2011 and January 29, 2011, we had outstanding purchase orders to acquire merchandise from vendors of $108.8 million and $76.5 million, including $3.3 million and $0.5 million of letters of credit outstanding. We have an option to cancel these commitments with no notice prior to shipment, except for private label purchase orders in which we are obligated to repay certain contractual amounts upon cancellation.

Litigation We are involved from time to time in claims, proceedings and litigation arising in the ordinary course of business. We have made accruals with respect to these matters, where appropriate, which are reflected in our condensed consolidated financial statements. For some matters, the amount of liability is not probable or the amount cannot be reasonable estimated and therefore accruals have not been made. We may enter into discussions regarding settlement of these matters, and may enter into settlement agreements if we believe settlement is in the best interest of the Company s shareholders.

A putative class action, *Chandra Berg et al. v. Zumiez Inc.*, was filed against the Company in the Los Angeles Superior Court under case number BC408410 on February 25, 2009. The Complaint alleged causes of action for failure to pay overtime wages to present and former store managers in California, failure to provide meal periods and rest breaks to store managers, failure to reimburse retail employees for clothing required by the Company s dress code, failure to reimburse retail employees for business expenses, failure to provide store managers with accurate itemized wage statements, failure to pay terminated store managers all wages due at the time of termination, unfair business practices and declaratory relief. Plaintiff filed a First Amended Complaint on April 2, 2010 which added an additional plaintiff/class representative and a new cause of action for penalties for alleged Labor Code violations under the Private Attorneys General Act. We filed an answer to the First Amended Complaint and conducted discovery. On February 8, 2010, we attended a mediation wherein no settlement was reached. Plaintiffs filed their motion for class certification, and we filed our opposition to class certification. Plaintiffs reply papers were filed on August 2, 2010. On September 1, 2010, the Company announced that it had reached an agreement to settle. The settlement agreement is $2.1 million, which includes settlement awards to class members, incentive payments to the two plaintiffs, attorneys fees and costs and claims administration costs. The court granted preliminary approval of the settlement on November 3, 2010, and granted final approval of the settlement on February 23, 2011. The claims administrator has distributed the settlement funds pursuant to the Court s order and the settlement agreement. The accrued charge of $2.1 million was recorded in selling, general and administrative expenses on the condensed consolidated statements of operations for the three months ended July 31, 2010 and was paid out on March 10, 2011.

Insurance Reserves We are responsible for medical and dental insurance claims up to a specified aggregate amount. We maintain a reserve for estimated medical and dental insurance claims based on historical claims experience and other estimated assumptions. The insurance reserve at July 30, 2011 and January 29, 2011 was $0.5 million and $0.4 million.

5. Fair Value Measurements We apply the following fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 Quoted prices in active markets for identical assets or liabilities;

Level 2 Quoted prices for similar assets or liabilities in active markets or inputs that are observable; and

Level 3 Inputs that are unobservable.

We follow the guidelines for assessing fair value measurements consistent with GAAP that requires an assessment of whether certain factors exist to indicate that the market for an instrument is not active at the measurement date. If, after evaluating those factors, the evidence indicates the market is not active, a company must determine whether recent quoted transaction prices are associated with distressed transactions.

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The following tables summarize assets measured at fair value on a recurring basis at July 30, 2011 and January 29, 2011 (in thousands):

	July 30, 2011		
	Level 1	Level 2	Level 3
Cash equivalents:			
Money market funds	$ 5,727	$	$
Marketable securities:			
Treasury and agency securities		3,011	
State and local government securities		107,408	
Variable-rate demand notes		7,325	
Long-term investments:			
State and local government securities			884
Equity investment			1,924

	January 29, 2011		
	Level 1	Level 2	Level 3
Cash equivalents:			
Money market funds	$ 928	$	$
State and local government securities		3,269	
Marketable securities:			
Treasury and agency securities		6,069	
State and local government securities		102,170	
Variable-rate demand notes		9,205	
Long-term investments:			
State and local government securities			870
Equity investment			1,896

Our policy is to recognize transfers into and transfers out of hierarchy levels as of the actual date of the event or change in circumstances that caused the transfer.

The Level 2 marketable securities primarily include state and local municipal securities, U.S. Treasury securities, U.S. Agency securities and variable-rate demand notes. Fair values are based on quoted market prices for similar assets or liabilities or determined using inputs that use readily observable market data that are actively quoted and can be validated through external sources, including third-party pricing services, brokers and market transactions.

The Level 3 state and local government securities represent a $1.0 million par value auction rate security, net of temporary impairment charge of $0.1 million. Our valuation method for the auction rate security is based on numerous assumptions including assessments of the underlying security, expected cash flows, credit ratings, liquidity and other relevant factors.

The Level 3 equity investment represents our 14.3% interest in a manufacturer of apparel and hard goods, which we acquired for $2.0 million on May 11, 2010. The equity investment is valued using comparative market multiples adjusted by an estimated discount factor. We have elected to apply fair value accounting for this investment, which would otherwise be accounted for under the equity method of accounting. We have elected fair value accounting, as we believe the terms of the contract are more properly reflected through the fair value method. The investment balance is reported in long-term investments on the condensed consolidated balance sheets, with the corresponding changes in the fair value recorded in other income (expense), net on the condensed consolidated statements of operations.

The investment agreement allows for a put option, where we have an option to sell our interest back to the investee for the greater of the initial purchase price of $2.0 million or the fair value of the investment. This put option is allowed any time following the fifth anniversary of the initial investment, but prior to the seventh anniversary of the initial investment. Additionally, the investment agreement allows for a call option, where the investee has an option to repurchase the interest from us for the fair value of the investment. This call option is allowed any time on or after the seventh anniversary of the initial investment. We have elected to apply fair value accounting for the put and call options. The put option has a nominal value and the call option has no fair value, given that the investment would be repurchased at its fair value if the call option were exercised.

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The assumptions, assessments and the interpretations of relevant market data are subject to uncertainties and are difficult to predict and require significant judgment. The use of different assumptions, applying different judgment to inherently subjective matters and changes in future market conditions could result in significantly different estimates of fair value.

The following tables present the changes in the Level 3 fair value category for the six months ended July 30, 2011 and July 31, 2010 (in thousands):

	State and Local Government Securities	Equity Investment
Beginning balance at January 29, 2011	$ 870	$ 1,896
Unrealized gain included in accumulated other comprehensive income (loss)	14	
Unrealized gain included in other income, net		28
Ending balance at July 30, 2011	$ 884	$ 1,924

	State and Local Government Securities	Equity Investment
Beginning balance at January 30, 2010	$ 872	$
Purchases		2,000
Unrealized loss included in accumulated other comprehensive income	(9)	
Unrealized loss included in other income, net		(5)
Ending balance at July 31, 2010	$ 863	$ 1,995

There were no assets measured at fair value on a nonrecurring basis for the six months ended July 30, 2011 and July 31, 2010.

6. Equity Awards We maintain the Zumiez Inc. 2005 Equity Incentive Plan (the 2005 Equity Incentive Plan) under which non-qualified stock options and restricted stock have been granted to employees and non-employee directors.

We account for stock-based compensation by which the estimated fair value of stock-based awards granted is recognized as compensation expense over the vesting period, net of estimated forfeitures. Stock-based compensation expense is recognized using an accelerated method for stock options and a straight-line basis for restricted stock. We estimate forfeitures of stock-based awards based on historical experience and expected future activity.

The fair value of restricted stock grants is measured based on the closing fair market value of our common stock on the date of grant. The fair value of stock option grants are estimated on the date of grant using the Black-Scholes option pricing method with the following weighted-average assumptions used for stock option grants issued during the six months ended July 30, 2011 and July 31, 2010:

	Six Months Ended July 30, 2011	Six Months Ended July 31, 2010
Dividend yield	%	%
Volatility rate	65.07%	67.57%
Average expected life (in years)	6.25	6.50
Average risk-free interest rate	1.54%	2.42%
Weighted-average fair value per share of stock options granted	$ 15.28	$ 12.32

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The following table summarizes our stock option activity for the six months ended July 30, 2011 (in thousands except grant date weighted-average exercise price and weighted-average remaining contractual life):

	Stock Options	Grant Date Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in Years)	Intrinsic Value (1)
Outstanding at January 29, 2011	1,118	$ 14.86		
Granted year to date	40	$ 25.31		
Exercised year to date	(118)	$ 7.37		
Forfeited year to date	(81)	$ 16.33		
Outstanding at July 30, 2011	959	$ 16.09	5.69	$ 11,917
Exercisable at July 30, 2011	584	$ 18.62	5.34	$ 6,367

(1) Intrinsic value for stock options is defined as the difference between the market price of the Company s common stock on the last business day of the quarter and the weighted average exercise price of in-the-money options outstanding at the end of each fiscal period. The market value per share was $26.57 at July 30, 2011.

The following table summarizes our restricted stock activity for the six months ended July 30, 2011 (in thousands except grant date weighted-average fair value):

	Restricted Stock	Grant Date Weighted Average Fair Value	Intrinsic Value (1)
Outstanding at January 29, 2011	592	$ 12.55	
Granted year to date	169	$ 25.66	
Vested year to date	(208)	$ 12.28	
Forfeited year to date	(37)	$ 17.68	
Outstanding at July 30, 2011	516	$ 16.58	$ 13,703

(1) Intrinsic value for restricted stock is defined as the market value of the outstanding restricted stock on the last business day of the quarter. The market value per share was $26.57 at July 30, 2011.

We recorded $1.4 million and $1.3 million of total stock-based compensation expense for the three months ended July 30, 2011 and July 31, 2010. We recorded $2.8 million and $2.5 million of total stock-based compensation expense for the six months ended July 30, 2011 and July 31, 2010.

At July 30, 2011, there was $7.9 million of total unrecognized compensation cost related to unvested stock options and restricted stock grants. This cost has a weighted-average recognition period of 1.2 years.

7. Comprehensive Income or Loss Comprehensive income or loss represents all changes in equity during a period except those resulting from investments by and distributions to shareholders. Comprehensive income (loss) for the three and six months ended July 30, 2011 and July 31, 2010 is as follows (in thousands):

	Three Months Ended		Six Months Ended	
	July 30, 2011	July 31, 2010	July 30, 2011	July 31, 2010
Net income (loss)	$ 2,591	$ (1,214)	$ 4,477	$ (3,114)
Net change in unrealized gains (losses) on available-for-sale investments, net of tax	62	3	111	(89)
Foreign currency translation	22		69	
Comprehensive income (loss)	$ 2,675	$ (1,211)	$ 4,657	$ (3,203)

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8. Earnings (Loss) Per Share, Basic and Diluted The following table sets forth the computation of basic and diluted earnings (loss) per share (in thousands, except per share amounts). The dilutive effect of stock options and restricted stock is applicable only in periods of net income.

	Three Months Ended		Six Months Ended	
	July 30, 2011	July 31, 2010	July 30, 2011	July 31, 2010
Net income (loss)	$ 2,591	$ (1,214)	$ 4,477	$ (3,114)
Weighted average common shares for basic earnings (loss) per share	30,521	29,954	30,432	29,846
Dilutive effect of stock options and restricted stock	560		640	
Weighted average common shares for diluted earnings (loss) per share	31,081	29,954	31,072	29,846
Basic earnings (loss) per share	$ 0.08	$ (0.04)	$ 0.15	$ (0.10)
Diluted earnings (loss) per share	$ 0.08	$ (0.04)	$ 0.14	$ (0.10)

Total anti-dilutive common stock options not included in the calculation of diluted earnings per share were approximately 0.3 million and 0.3 million for the three and six months ended July 30, 2011.

9. Exit or Disposal Activities On March 2, 2010, we acquired a 168,450 square foot building in Corona, California for $11.8 million and we have relocated our distribution facility to this facility to be more effective at distributing our products. In July 2010, we entered into an amendment of the lease for our current combined home office, ecommerce fulfillment center and the exited distribution facility in Everett, Washington, which terminated our lease commitments for a portion of the leased space in exchange for additional charges to be paid over the life of the remaining lease period (through June 2017). The lease termination costs recorded reflect the present value of these future charges.

Cumulatively, in conjunction with the closure of the Everett, Washington distribution facility, we recorded $0.9 million of employee benefit costs (severance and performance bonuses), $0.6 million of lease termination costs and $0.8 million of other costs to exit the facility. Additionally, we incurred a $0.3 million charge on disposal of long-lived assets and we recognized a $0.2 million benefit related to deferred rent liability. These amounts were included in cost of goods sold on the condensed consolidated statements of operations. We do not expect to incur material additional costs related to the relocation.

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The following table is a summary of the exit and disposal activity and liability balances as a result of this relocation (in thousands):

	Employee benefit costs	Lease termination costs	Other exit costs	Total
January 30, 2010	$	$	$	$
Additions	882		288	1,170
Payments	(716)		(198)	(914)
May 1, 2010	166		90	256
Additions		1,051	305	1,356
Payments	(111)	(186)	(253)	(550)
Adjustments	9	(457)		(448)
July 31, 2010	64	408	142	614
Additions			208	208
Payments	(19)	(60)	(341)	(420)
Adjustments		2		2
October 30, 2010	45	350	9	404
Additions			5	5
Payments	(30)	(59)	(14)	(103)
Adjustments		2		2
January 29, 2011	15	293		308
Payments	(15)	(23)		(38)
Adjustments		2		2
April 30, 2011		272		272
Payments		(12)		(12)
Adjustments		2		2
July 30, 2011 (1)	$	$ 262	$	$ 262

(1) The exit or disposal provisions at July 30, 2011 are included in other liabilities and long-term other liabilities on the condensed consolidated balance sheet.

10. Subsequent Event On August 29, 2011, we renewed and amended our secured credit agreement with Wells Fargo Bank, N.A., and the prior facility agreement, which was scheduled to terminate on September 1, 2011, was terminated. The credit agreement provides us with a secured revolving credit facility until September 1, 2013 of up to $25.0 million, which, pursuant to an accordion feature, may be increased to $35.0 million at our discretion.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this document. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those discussed in Item 1A Risk Factors in our Form 10-K filed with the SEC on March 15, 2011 and in this Form 10-Q.

Forward-looking statements relate to our expectations for future events and future financial performance. Generally, the words anticipates, expects, intends, may, should, plans, believes, predicts, potential, continue and similar expressions identify forward-looking statements. Forward-looking statements involve risks and uncertainties, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements. These statements are only predictions. Actual events or results may differ materially. Factors which could affect our financial results are described below under the heading Risk Factors and in Item 1A Risk Factors of our Form 10-K referred to in the preceding paragraph. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we nor any other person assume responsibility for the accuracy and completeness of the forward-looking statements. We undertake no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

References in the following discussion to we, us, our, the Company and similar references mean Zumiez Inc. and its wholly-owned subsidiaries, unless otherwise expressly stated or the context otherwise requires.

Overview

We are a specialty retailer of action sports related apparel, footwear, equipment and accessories operating under the Zumiez brand name. At July 30, 2011, we operated 424 stores primarily located in shopping malls, giving us a presence in 38 states and Canada. Our stores cater to young men and women between the ages of 12 and 24 who seek popular brands representing a lifestyle centered on activities that include skateboarding, surfing, snowboarding, BMX and motocross. We support the action sports lifestyle and promote our brand through a multi-faceted marketing approach that is designed to integrate our brand image with our customers activities and interests. This approach, combined with our differentiated merchandising strategy, store design, comprehensive training programs and passionate employees, allows us to provide an experience for our customers that we believe is consistent with their attitudes, fashion tastes and identities and is otherwise unavailable in most malls. Accordingly, our success is largely dependent upon our ability to anticipate, identify and respond to the fashion tastes of our customers and to provide merchandise that satisfies customer demands.

General

Net sales constitute gross sales net of actual and estimated returns and deductions for promotions. Net sales include our in-store sales and our ecommerce sales, which includes ecommerce shipping revenue. Ecommerce sales were 5.3% and 2.9% of total net sales for the three months ended July 30, 2011 and July 31, 2010 and 5.7% and 3.0% of total net sales for the six months ended July 30, 2011 and July 31, 2010. Sales of gift cards are deferred and recognized when gift cards are redeemed. The amount of the gift card liability is determined taking into account our estimate of the portion of gift cards that will not be redeemed or recovered (gift card breakage). Gift card breakage is recognized as revenue after 24 months, at which time the likelihood of redemption is considered remote based on our historical redemption data.

We report comparable store sales based on net sales beginning on the first anniversary of the first day of operation of a new store. Our comparable store sales also include our ecommerce sales. Changes in our comparable store sales between two periods are based on net sales of stores which were in operation during both of the two periods being compared and, if a store is included in the calculation of comparable store sales for only a portion of one of the two periods being compared, then that store is included in the calculation for only the comparable portion of the other period. Any change in square footage of an existing comparable store, including remodels, does not eliminate that store from inclusion in the calculation of comparable store sales. There may be variations in the way in which some of our competitors and other retailers calculate comparable or same store sales. As a result, data herein regarding our comparable store sales may not be comparable to similar data made available by our competitors or other retailers.

Cost of goods sold consists of branded merchandise costs and our private label merchandise costs including design, sourcing, importing and inbound freight costs. Our cost of goods sold also includes shrinkage and buying, occupancy, distribution and warehousing costs. This may not be comparable to the way in which our competitors or other retailers compute their cost of goods sold. We receive cash consideration from vendors, which have been recorded as a reduction of cost of goods sold if the inventory has sold, as a reduction of the carrying value of the inventory if the inventory is still on hand, or a reduction of selling, general and administrative expense if the amounts are reimbursements of specific, incremental and identifiable costs of selling the vendors products.

With respect to the freight component of our ecommerce sales, we arrange and pay the freight for our customers and bill them for this service, unless our customers have their product shipped to one of our stores or we have free shipping promotions to our customers, in which case we do not bill our customers. Such amounts billed are included in net sales and the related freight cost is charged to cost of goods sold.

Selling, general and administrative expenses consist primarily of store personnel wages and benefits, administrative staff and infrastructure expenses, outbound freight, store supplies, depreciation on fixed assets at our home office and stores, facility expenses and training, advertising and marketing costs. Credit card fees, insurance, public company expenses, legal expenses and other miscellaneous operating costs are also included in selling, general and administrative expenses. This may not be comparable to the way in which our competitors or other retailers compute their selling, general and administrative expenses.

Key Performance Indicators

Our management evaluates the following items, which we consider key performance indicators, in assessing our performance:

Comparable store sales. As previously described in detail under the caption General, comparable store sales provide a measure of sales growth for stores open at least one year over the comparable prior year period.

We consider comparable store sales to be an important indicator of our current performance. Comparable store sales results are important to achieve leveraging of our costs, including store payroll, store supplies and rent. Comparable store sales also have a direct impact on our total net sales, cash and working capital.

Gross profit. Gross profit measures whether we are optimizing the price and inventory levels of our merchandise. Gross profit is the difference between net sales and cost of goods sold. Any inability to obtain acceptable levels of initial markups or any significant increase in our use of markdowns could have an adverse effect on our gross profit and results of operations.

Operating profit. We view operating profit as a key indicator of our success. The key drivers of operating profit are comparable store sales, gross profit, our ability to control selling, general and administrative expenses and our level of capital expenditures affecting depreciation expense.

Store productivity. We review our stores operating profit as a measure of the stores profitability.

Critical Accounting Estimates

Our condensed consolidated financial statements have been prepared in conformance with GAAP. In connection with the preparation of the condensed consolidated financial statements, we are required to make assumptions and estimates about future events and apply judgments that affect the reported amount of assets, liabilities, revenue, expenses and the related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that we believe to be relevant at the time the condensed consolidated financial statements are prepared. On a regular basis, we review the accounting policies, assumptions, estimates and judgments to ensure that the condensed consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

There have been no significant changes to our critical accounting estimates as discussed in our Annual Report on Form 10-K for the fiscal year ended January 29, 2011.

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Results of Operations

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

	Three Months Ended		Six Months Ended	
	July 30, 2011	**July 31, 2010**	**July 30, 2011**	**July 31, 2010**
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	66.8	68.8	67.6	70.0
Gross profit	33.2	31.2	32.4	30.0
Selling, general and administrative expenses	30.0	33.6	29.6	33.0
Operating profit (loss)	3.2	(2.4)	2.8	(3.0)
Interest and other income, net	0.4	0.4	0.5	0.4
Earnings (loss) before income taxes	3.6	(2.0)	3.3	(2.6)
Provision (benefit) for income taxes	1.3	(0.8)	1.2	(0.9)
Net income (loss)	2.3%	(1.2)%	2.1%	(1.7)%

Three Months (13 weeks) Ended July 30, 2011 Compared With Three Months (13 weeks) Ended July 31, 2010

Net Income

Net income for the three months ended July 30, 2011 was $2.6 million, or $0.08 per diluted share, compared with a net loss of $1.2 million, or $0.04 per diluted share, for the three months ended July 31, 2010. Our effective income tax rate for the three months ended July 30, 2011 was 35.0% compared to 38.3% for the three months ended July 31, 2010.

Net Sales

Net sales were $112.2 million for the three months ended July 30, 2011 compared to $97.7 million for the three months ended July 31, 2010, an increase of $14.5 million or 14.9%. The increase reflected a comparable store sales increase of 7.5% for the three months ended July 30, 2011 as well as the net addition of 31 stores (32 new stores offset by one store closure) subsequent to July 31, 2010.

The increase in comparable stores sales was primarily driven by an increase in dollars per transaction, slightly offset by a decline in comparable store transactions. Dollars per transaction increased due to an increase in average unit retail, partially offset by a decrease in units per transaction. Comparable store sales increases in footwear, men s clothing, junior s clothing, hardgoods and accessories were partially offset by comparable store sales decrease in boy s clothing. For information as to how we define comparable stores, see General above.

Gross Profit

Gross profit was $37.3 million for the three months ended July 30, 2011 compared to $30.5 million for the three months ended July 31, 2010, an increase of $6.8 million, or 22.3%. As a percentage of net sales, gross profit increased 200 basis points for the three months ended July 30, 2011 to 33.2% from 31.2% for the three months ended July 31, 2010. The increase was primarily due to a 100 basis points decrease related to costs incurred in the three months ended July 31, 2010 associated with the relocation of our distribution center and a 60 basis points decrease due to leveraging our store occupancy costs over a 7.5% comparable store sales gain.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were $33.7 million for the three months ended July 30, 2011 compared to $32.9 million for the three months ended July 31, 2010, an increase of $0.8 million, or 2.7%. SG&A expenses as a percent of sales decreased by 360 basis points for the three months ended July 30, 2011 to 30.0% compared to 33.6% for the three months ended July 31, 2010. The decrease was primarily due to a 220 basis points impact of a litigation settlement of $2.1 million incurred in the three months ended July 31, 2010, 100 basis points in store operating efficiencies and a 90 basis points decrease in corporate costs, partially offset by an increase in web operating expenses as a percent of total sales of 50 basis points due to the growth of the web business.

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Six Months (26 weeks) Ended July 30, 2011 Compared With Six Months (26 weeks) Ended July 31, 2010

Net Income

Net income for the six months ended July 30, 2011 was $4.5 million, or $0.14 per diluted share, compared with a net loss of $3.1 million, or $0.10 per diluted share, for the six months ended July 31, 2010. Our effective income tax rate for the six months ended July 30, 2011 was 37.0% compared to 35.6% for the six months ended July 31, 2010.

Net Sales

Net sales were $218.1 million for the six months ended July 30, 2011 compared to $186.8 million for the six months ended July 31, 2010, an increase of $31.3 million or 16.7%. The increase reflected a comparable store sales increase of 9.9% for the six months ended July 30, 2011 as well as the net addition of 31 stores (32 new stores offset by one store closure) subsequent to July 31, 2010.

The increase in comparable stores sales was primarily driven by increases in comparable store transactions and dollars per transaction. Dollars per transaction increased due to an increase in average unit retail, partially offset by a decrease in units per transaction. Comparable store sales increases in footwear, men s clothing, accessories and junior s clothing were partially offset by comparable store sales decreases in hardgoods and boy s clothing. For information as to how we define comparable stores, see General above.

Gross Profit

Gross profit was $70.7 million for the six months ended July 30, 2011 compared to $56.0 million for the six months ended July 31, 2010, an increase of $14.7 million, or 26.3%. As a percentage of net sales, gross profit increased 240 basis points for the six months ended July 30, 2011 to 32.4% from 30.0% for the six months ended July 31, 2010. The increase was primarily due to a 120 basis points decrease related to costs incurred in the six months ended July 31, 2010 associated with the relocation of our distribution center and a 100 basis points decrease due to leveraging our store occupancy cost over a 9.9% comparable store sales gain.

Selling, General and Administrative Expenses

Selling, general and administrative (SG&A) expenses were $64.6 million for the six months ended July 30, 2011 compared to $61.6 million for the six months ended July 31, 2010, an increase of $3.0 million, or 4.9%. SG&A expenses as a percent of sales decreased by 340 basis points for the six months ended July 30, 2011 to 29.6% compared to 33.0% for the six months ended July 31, 2010. The decrease was primarily due to 190 basis points in store operating efficiencies, a 110 basis points impact of a litigation settlement of $2.1 million incurred in the six months ended July 31, 2010 and a 70 basis points decrease in corporate costs, partially offset by an increase in web operating expenses as a percent of total sales of 40 basis points due to the growth of the web business.

Liquidity and Capital Resources

Our primary uses of cash are for operational expenditures, capital investments, inventory purchases, store remodeling, store fixtures and ongoing infrastructure improvements such as technology enhancements and distribution capabilities. Historically, our main sources of liquidity have been cash flows from operations.

The significant components of our working capital are inventories and liquid assets such as cash, cash equivalents, marketable securities and receivables, reduced by accounts payable and accrued expenses. Our working capital position benefits from the fact that we generally collect cash from sales to customers the same day or within several days of the related sale, while we typically have longer payment terms with our vendors.

Our capital requirements include construction and fixture costs related to the opening of new stores and remodeling expenditures for existing stores. Future capital requirements will depend on many factors, including the pace of new store openings, the availability of suitable locations for new stores and the nature of arrangements negotiated with landlords. In that regard, our net investment to open a new store has varied significantly in the past due to a number of factors, including the geographic location and size of the new store, and is likely to vary significantly in the future. In addition, we will incur construction costs in fiscal 2011 and fiscal 2012 related to building our new home office in Lynnwood, Washington.

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During fiscal 2011, we expect to spend approximately $35 million to $37 million on capital expenditures, which will primarily relate to leasehold improvements and fixtures for the 45 new stores we plan to open in fiscal 2011 and the construction of our new home office building in Lynnwood, Washington. There can be no assurance that actual fiscal 2011 capital expenditures will not differ from this expected amount.

Operating Activities

Net cash provided by operating activities increased by $10.8 million to $15.2 million for the six months ended July 30, 2011 from $4.4 million for the six months ended July 31, 2010. Our operating cash flows result primarily from cash received from our customers, offset by cash payments we make for inventory, employee compensation, store occupancy expenses and other operational expenditures. Cash received from our customers generally corresponds to our net sales. Because our customers primarily use credit cards or cash to buy from us, our receivables from customers settle quickly. Changes to our operating cash flows have historically been driven primarily by changes in operating income and changes to the components of working capital, as well as changes to non-cash items such as depreciation, amortization and accretion, deferred taxes, and excess tax benefit from stock-based compensation.

Investing Activities

Net cash used in investing activities was $15.1 million for the six months ended July 30, 2011, related to $13.9 million of capital expenditures primarily for new store openings and $1.2 million in net purchases of marketable securities. Net cash used in investing activities was $1.6 million for the six months ended July 31, 2010, related to $20.7 million of capital expenditures primarily for the purchase of our distribution center in Corona, California, new store openings and home office and distribution center capital projects, partially offset by $19.1 million in net sales and maturities of marketable securities.

Financing Activities

Net cash provided by financing activities for the six months ended July 30, 2011 was $2.7 million related to proceeds from stock-based compensation exercises and the related tax benefit. Net cash provided by financing activities for the six months ended July 31, 2010 was $2.4 million related to the proceeds received from stock-based compensation exercises and the related tax benefit.

Sources of Liquidity

Our most significant sources of liquidity continue to be funds generated by operating activities and available cash, cash equivalents and current marketable securities. We expect these sources of liquidity and available borrowings under our revolving credit facility will be sufficient to meet our foreseeable cash requirements for operations and planned capital expenditures for at least the next twelve months. Beyond this time frame, if cash flows from operations and borrowings under our revolving credit facility are not sufficient to meet our capital requirements, then we will be required to obtain additional equity or debt financing in the future. However, there can be no assurance that equity or debt financing will be available to us when we need it, or if available, that the terms will be satisfactory to us and not dilutive to our then-current shareholders.

On June 10, 2009, we renewed and amended our secured credit agreement with Wells Fargo HSBC Trade Bank, N.A., and the prior facility agreement was terminated. The credit agreement provides us with a secured revolving credit facility until September 1, 2011 of up to $25.0 million. The secured revolving credit facility provides for the issuance of a standby letter of credit in an amount not to exceed $5.0 million outstanding at any time and with a term not to exceed 365 days. The commercial line of credit provides for the issuance of a commercial letter of credit in an amount not to exceed $10.0 million and with terms not to exceed 120 days. The amount of borrowings available at any time under our secured revolving credit facility is reduced by the amount of standby and commercial letters of credit outstanding at that time. There were no outstanding borrowings under the secured revolving credit facility at July 30, 2011 and January 29, 2011. We had open commercial letters of credit outstanding under our secured revolving credit facility of $3.3 million at July 30, 2011 and $0.5 million at January 29, 2011. The secured revolving credit facility bears interest at the Daily One Month LIBOR rate plus 1.00%. The credit agreement contains a number of restrictions and covenants that generally limit our ability to, among other things, (1) incur additional debt, (2) undergo a change in ownership and (3) enter into certain transactions. The credit agreement also contains financial covenants that require us to meet certain specified financial tests and ratios, including, a maximum net loss not to exceed $10.0 million after taxes on a trailing four-quarter basis provided, that, there shall be added to net income all charges for impairment of goodwill and store assets not to exceed $5.0 million in aggregate, and a minimum quick ratio of 1.25. The quick ratio is defined as our cash and near cash equivalents plus certain defined receivables divided by the outstanding borrowings. All of our personal property, including, among other things, our inventory, equipment and fixtures, has been pledged to secure our obligations under the credit agreement. We must also provide financial information and statements to our lender. We were in compliance with all such covenants at July 30, 2011.

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On August 29, 2011, we renewed and amended our secured credit agreement with Wells Fargo Bank, N.A., and the prior facility agreement, which was scheduled to terminate on September 1, 2011, was terminated. The credit agreement provides us with a secured revolving credit facility until September 1, 2013 of up to $25.0 million, which, pursuant to an accordion feature, may be increased to $35.0 million at our discretion.

Contractual Obligations and Commercial Commitments

There were no material changes outside the ordinary course of business in our contractual obligations during the six months ended July 30, 2011. The following table summarizes the total amount of future payments due under our contractual obligations at July 30, 2011 (in thousands):

	Total	Fiscal 2011	Fiscal 2012 and Fiscal 2013	Fiscal 2014 and Fiscal 2015	Thereafter
Operating lease obligations	$ 389,208	$ 25,580	$ 104,913	$ 99,624	$ 159,091
Purchase obligations	108,843	108,843			
Total	$ 498,051	$ 134,423	$ 104,913	$ 99,624	$ 159,091

We occupy our retail stores and our current combined home office and ecommerce fulfillment center under operating leases generally with terms of five to ten years. At July 30, 2011, we were committed to property owners for operating lease obligations for $389.2 million. A majority of our leases provide for ongoing co-tenancy requirements or early cancellation clauses that would further lower rental rates, or permit lease terminations, or both, in the event that co-tenants cease to operate for specific periods or if certain sales levels are not met in specific periods. Most of the store leases require payment of a specified minimum rent and contingent rent based on a percentage of the store s net sales in excess of a specified threshold. Amounts in the above table do not include contingent rent, real estate taxes, insurance or common area maintenance costs unless these costs are fixed and determinable.

At July 30, 2011, we had outstanding purchase orders to acquire merchandise from vendors of $108.8 million, including $3.3 million of letters of credit outstanding. We have an option to cancel these commitments with no notice prior to shipment, except for private label purchase orders in which we are obligated to repay certain contractual amounts upon cancellation.

Off-Balance Sheet Obligations

We did not have any off-balance sheet obligations at July 30, 2011.

Impact of Inflation

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

Risk Factors

Investing in our securities involves a high degree of risk. The following risk factors, issues and uncertainties should be considered in evaluating our future prospects. In particular, keep these risk factors in mind when you read forward-looking statements elsewhere in this report. Forward-looking statements relate to our expectations for future events and time periods. Generally, the words anticipate, believe, expect, intend and similar expressions identify forward-looking statements. Forward-looking statements involve risks and uncertainties, and future events and circumstances could differ significantly from those anticipated in the forward-looking statements. Any of the following risks could harm our business, operating results or financial condition and could result in a complete loss of your investment. Additional risks and uncertainties that are not yet identified or that we currently think are immaterial may also harm our business and financial condition in the future.

Significant fluctuations and volatility in the price of cotton, foreign labor costs and other raw materials used in the production of our merchandise may have a material adverse effect on our business, results of operations and financial conditions.

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Increases in the cost of cotton, foreign labor costs or other raw materials used in the production of our merchandise can result in higher costs in the price we pay for this merchandise. The costs for cotton are affected by weather, consumer demand, speculation on the commodities market and other factors that are generally unpredictable and beyond our control. Our gross profit and earnings per share could be adversely affected to the extent that the selling prices of our products do not increase proportionately with the increases in the costs of cotton or other materials. Increasing labor costs and oil-related product costs, such as manufacturing and transportation costs, could also adversely impact gross profit. Additionally, significant changes in the relationship between carrier capacity and shipper demand could increase transportation costs, which could also adversely impact gross profit.

We are aware of increasing cotton, oil and other input costs that affect our cost of goods sold. We are working with our vendors and private label manufacturers to manage these cost increases. Our current expectation is that increases in product cost will be higher in the second half of 2011 versus the first half. While we believe we have strategies in place to mitigate the increase in cost, there can be no assurance our efforts will be successful and our gross profit margins may decline.

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

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

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

In order to generate customer traffic we depend heavily on locating our stores in prominent locations within successful shopping malls. Sales at these stores are derived, in part, from the volume of traffic in those malls. Our stores benefit from the ability of a mall s other tenants to generate consumer traffic in the vicinity of our stores and the continuing popularity of malls as shopping destinations. Our sales volume and mall traffic generally may be adversely affected by, among other things, economic downturns in a particular area, competition from ecommerce retailers, non-mall retailers and other malls, increases in gasoline prices and the closing or decline in popularity of other stores in the malls in which we are located. An uncertain economic outlook could curtail new shopping mall development, decrease shopping mall traffic, reduce the number of hours that shopping mall operators keep their shopping malls open or force them to cease operations entirely. A reduction in mall traffic as a result of these or any other factors could have a material adverse effect on our business, results of operations and financial condition.

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

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

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

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

identify suitable store locations, the availability of which is outside of our control;

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

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

The expansion of our store base to Canada may present increased risks due to our limited familiarity with that market.

In fiscal 2011, we opened store locations in Canada. The Canadian market may have different competitive conditions, consumer tastes and discretionary spending patterns that our existing markets. As a result, new stores in that market may be less successful than our stores in the United States. Additionally, consumers in the Canadian market may not be familiar with our brand, and we may need to build brand awareness in that market. Furthermore, we have limited experience with the legal and regulatory environments and market practices outside of the United States and cannot guarantee that we will be able penetrate or successfully operate in the Canadian market. We may also incur additional costs in complying with applicable Canadian laws and regulations as they pertain to both our products and our operations.

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

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

The current uncertainty surrounding the United States economy coupled with cyclical economic trends in action sports retailing could have a material adverse effect on our results of operations.

The action sports retail industry historically has been subject to substantial cyclicality. As economic conditions in the United States change, the trends in discretionary consumer spending become unpredictable and discretionary consumer spending could be reduced due to uncertainties about the future. When discretionary consumer spending is reduced, purchases of action sports apparel and related products may decline. The current uncertainty in the United States economy and increased government debt spending may have a material adverse impact on our results of operations and financial position.

Because of this cycle, we believe the value message has become more important to consumers. As a retailer that sells approximately 82% branded merchandise, this trend may negatively affect our business, as we generally will have to charge more than vertically integrated private label retailers.

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

Our sales and profitability are typically disproportionately higher in the third and fourth fiscal quarters of each fiscal year due to increased sales during the back-to-school and winter holiday shopping seasons. Sales during these periods cannot be used as an accurate indicator of annual results. Our sales in the first and second fiscal quarters are typically lower than in our third and fourth fiscal quarters due, in part, to the traditional retail slowdown immediately following the winter holiday season. As a result of this seasonality, any factors negatively affecting us during the last half of the year, including unfavorable economic

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

Our quarterly results of operations are volatile and may decline.

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

- the timing of new store openings and the relative proportion of our new stores to mature stores;
- whether we are able to successfully integrate any new stores that we acquire and the presence or absence of any unanticipated liabilities in connection therewith;
- fashion trends and changes in consumer preferences;
- calendar shifts of holiday or seasonal periods;
- changes in our merchandise mix;
- timing of promotional events;
- general economic conditions and, in particular, the retail sales environment;
- actions by competitors or mall anchor tenants;
- weather conditions;
- the level of pre-opening expenses associated with our new stores; and
- inventory shrinkage beyond our historical average rates.

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

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

Our business is susceptible to weather conditions that are out of our control, including the potential risks of unpredictable weather patterns and any weather patterns associated with naturally occurring global climate change, and the resultant unseasonable weather could have a negative impact on our results of operations.

Our business is susceptible to unseasonable weather conditions. For example, extended periods of unseasonably warm temperatures (including any weather patterns associated with global warming and cooling) during the winter season or cool weather during the summer season could render a portion of our inventory incompatible with those unseasonable conditions. These prolonged unseasonable weather conditions, particularly in regions of the United States where we have a concentration of stores, could have a material adverse effect on our business and results of operations.

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

The teenage and young adult retail apparel, hardgoods and accessories industry is highly competitive. We compete with other retailers for vendors, teenage and young adult customers, suitable store locations, qualified store associates and management personnel. In the softgoods market, which includes apparel, accessories and footwear, we currently compete with other teenage-focused retailers. In addition, in the softgoods market we compete with independent specialty shops, department stores and direct marketers that sell similar lines of merchandise and target customers through catalogs and ecommerce. In the hardgoods market, which includes skateboards, snowboards, bindings, components and other equipment, we compete directly or indirectly with other specialty retailers that compete with us across a significant portion of our merchandising categories, such as local snowboard and skate shops, large-format sporting goods stores and chains and ecommerce retailers.

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

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

Our business is dependent on continued good relations with our vendors. In particular, we believe that we generally are able to obtain attractive pricing and other terms from vendors because we are perceived as a desirable customer, and deterioration in our relationship with our vendors would likely have a material adverse effect on our business. There can be no assurance that our vendors will provide us with an adequate supply or quality of products or acceptable pricing. Our vendors could discontinue selling to us or raise the prices they charge at any time. There can be no assurance that we will be able to acquire desired merchandise in sufficient quantities on terms acceptable to us in the future. In addition, certain of our vendors sell their products directly to the retail market and therefore compete with us directly and other vendors may decide to do so in the future. There can be no assurance that such vendors will not decide to discontinue supplying their products to us, supply us only less popular or lower quality items, raise the prices they charge us or focus on selling their products directly. In addition, a number of our vendors are smaller, less capitalized companies and are more likely to be impacted by unfavorable general economic and market conditions than larger and better capitalized companies. These smaller vendors may not have sufficient liquidity during economic downturns to properly fund their businesses and their ability to supply their products to us could be negatively impacted. Any inability to acquire suitable merchandise at acceptable prices, or the loss of one or more key vendors, would have a material adverse effect on our business, results of operations and financial condition.

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

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

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

Our success depends in part upon our ability to attract, motivate and retain a sufficient number of qualified employees, including divisional managers, regional managers, district managers, store managers and store associates, who understand and appreciate our corporate culture based on a passion for the action sports lifestyle and are able to adequately represent this culture to our customers. Qualified individuals of the requisite caliber, skills and number needed to fill these positions may be in short supply in some areas, and the employee turnover rate in the retail industry is high. Competition for qualified employees could require us to pay higher wages to attract a sufficient number of suitable employees. If we are unable to hire and retain store managers and store associates capable of consistently providing a high level of customer service, as demonstrated by their enthusiasm for our culture and knowledge of our merchandise, our ability to open new stores may be impaired and the performance of our existing and new stores could be materially adversely affected. We are also dependent

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upon temporary personnel to adequately staff our stores, distribution center and ecommerce fulfillment center particularly during busy periods such as the back-to-school and winter holiday seasons. There can be no assurance that we will receive adequate assistance from our temporary personnel, or that there will be sufficient sources of temporary personnel. Although none of our employees is currently covered by collective bargaining agreements, we cannot guarantee that our employees will not elect to be represented by labor unions in the future, which could increase our labor costs and could subject us to the risk of work stoppages and strikes. Any such failure to meet our staffing needs, any material increases in employee turnover rates, any increases in labor costs or any work stoppages, interruptions or strikes could have a material adverse effect on our business or results of operations.

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

Our home office and ecommerce fulfillment center are located in Washington, our sole distribution center is located in California and a substantial number of our stores are located in the western half of the United States. We also have a substantial number of stores in the New York/New Jersey region and Texas. As a result, our business may be more susceptible to regional factors than the operations of more geographically diversified competitors. These factors include, among others, economic and weather conditions, demographic and population changes and fashion tastes. In addition, we rely on a single distribution center in the United States to receive, store and distribute the vast majority of our merchandise to our domestic stores. As a result, a natural disaster or other catastrophic event, such as an earthquake affecting the West Coast, could significantly disrupt our operations and have a material adverse effect on our business, results of operations and financial condition.

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

We do not own any of our retail stores or our current combined home office and ecommerce fulfillment center, but instead we lease these facilities under operating leases. Payments under these operating leases account for a significant portion of our operating expenses and has historically been our third largest expense behind cost of sales and our employee related costs. For example, total rental expense, including additional rental payments (or percentage rent) based on sales of some of the stores, common area maintenance charges and real estate taxes, under operating leases was $32.7 million and $29.9 million for the six months ended July 30, 2011 and July 31, 2010. At July 30, 2011, we were committed to property owners for operating lease obligations for $389.2 million. In addition, substantially all of our store leases provide for additional rental payments based on sales of the respective stores, as well as common area maintenance charges, and require that we pay real estate taxes. These amounts generally escalate each year. We expect that any new stores we open will also be leased by us under operating leases, which will further increase our operating lease expenses.

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

- increasing our vulnerability to general adverse economic and industry conditions;
- limiting our ability to obtain additional financing;
- requiring that a substantial portion of our available cash be applied to pay our rental obligations, thus reducing cash available for other purposes; and
- limiting our flexibility in planning for or reacting to changes in our business or in the industry in which we compete, and placing us at a disadvantage with respect to some of our competitors.

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

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

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On June 10, 2009, we renewed and amended our secured credit agreement with Wells Fargo HSBC Trade Bank, N.A., and the prior facility agreement was terminated. The credit agreement provides us with a secured revolving credit facility until September 1, 2011 of up to $25.0 million. The secured revolving credit facility provides for the issuance of a standby letter of credit in an amount not to exceed $5.0 million outstanding at any time and with a term not to exceed 365 days. The commercial line of credit provides for the issuance of a commercial letter of credit in an amount not to exceed $10.0 million and with terms not to exceed 120 days. The amount of borrowings available at any time under our secured revolving credit facility is reduced by the amount of standby and commercial letters of credit outstanding at that time. There were no outstanding borrowings under the secured revolving credit facility at July 30, 2011 and January 29, 2011. We had open commercial letters of credit outstanding under our secured revolving credit facility of $3.3 million at July 30, 2011 and $0.5 million at January 29, 2011. The secured revolving credit facility bears interest at the Daily One Month LIBOR rate plus 1.00%. The credit agreement contains a number of restrictions and covenants that generally limit our ability to, among other things, (1) incur additional debt, (2) undergo a change in ownership and (3) enter into certain transactions. The credit agreement also contains financial covenants that require us to meet certain specified financial tests and ratios, including, a maximum net loss not to exceed $10.0 million after taxes on a trailing four-quarter basis provided, that, there shall be added to net income all charges for impairment of goodwill and store assets not to exceed $5.0 million in aggregate, and a minimum quick ratio of 1.25. The quick ratio is defined as our cash and near cash equivalents plus certain defined receivables divided by the outstanding borrowings. All of our personal property, including, among other things, our inventory, equipment and fixtures, has been pledged to secure our obligations under the credit agreement. We must also provide financial information and statements to our lender. We were in compliance with all such covenants at July 30, 2011.

On August 29, 2011, we renewed and amended our secured credit agreement with Wells Fargo Bank, N.A., and the prior facility agreement, which was scheduled to terminate on September 1, 2011, was terminated. The credit agreement provides us with a secured revolving credit facility until September 1, 2013 of up to $25.0 million, which, pursuant to an accordion feature, may be increased to $35.0 million at our discretion.

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

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

Our business could suffer if our ability to acquire financing is reduced or eliminated.

In the current economic environment, we cannot be assured that our borrowing relationship with our lender will continue or that our lender will remain able to support its commitments to us in the future. If our lender fails to do so, then we may not be able to secure alternative financing on commercially reasonable terms, or at all.

Our business could suffer as a result of small parcel delivery services such as United Parcel Service or Federal Express being unable to distribute our merchandise.

We rely upon small parcel delivery services for our product shipments, including shipments to, from and between our stores. Accordingly, we are subject to risks, including employee strikes and inclement weather, which may affect their ability to meet our shipping needs. Among other things, any circumstances that require us to use other delivery services for all or a portion of our shipments could result in increased costs and delayed deliveries and could harm our business materially. In addition, although we have contracts with small parcel delivery services, we and the service providers have the right to terminate these contracts upon 30-90 days written notice. Although the contracts with these small parcel delivery services provide certain discounts from the shipment rates in effect at the time of shipment, the contracts do not limit their ability to raise the shipment rates at any time. Accordingly, we are subject to the risk that small parcel delivery services may increase the rates they charge, that they may terminate their contracts with us, that they may decrease the rate discounts provided to us when an existing contract is renewed or that we may be unable to agree on the terms of a new contract with them, any of which could materially adversely affect our operating results.

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

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

Additionally, our products are subject to regulation of and regulatory standards set by various governmental authorities with respect to quality and safety. Regulations and standards in this area are currently in place. These regulations and standards may change from time to time. Our inability to comply on a timely basis with regulatory requirements could result in significant fines or penalties, which could adversely affect our reputation and sales. Issues with the quality and safety of merchandise we sell in our stores, regardless of our culpability, or customer concerns about such issues, could result in damage to our reputation, lost sales, uninsured product liability claims or losses, merchandise recalls and increased costs.

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

Sales from private label merchandise accounted for 18% and 16% of our net sales in fiscal 2010 and fiscal 2009 and generally carries higher gross margins than our other merchandise. We may take steps to increase the percentage of net sales of private label merchandise in the future, although there can be no assurance that we will be able to achieve increases in private label merchandise sales as a percentage of net sales. Our failure to anticipate, identify and react in a timely manner to fashion trends with our private label merchandise, would likely have a material adverse effect on our comparable store sales, financial condition and results of operations.

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

Over the past several years, we have made improvements to our infrastructure and existing hardware and software systems, as well as implemented new systems. If these or any other information systems and software do not work effectively, this could adversely impact the promptness and accuracy of our transaction processing, financial accounting and reporting and our ability to manage our business and properly forecast operating results and cash requirements. To manage the anticipated growth of our operations and personnel, we may need to continue to improve our operational and financial systems, transaction processing, procedures and controls, and in doing so could incur substantial additional expenses that could impact our financial results.

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

We believe that our trademarks and domain names are valuable assets that are critical to our success. The unauthorized use or other misappropriation of our trademarks or domain names could diminish the value of the Zumiez brand, our store concept, our private label brands or our goodwill and cause a decline in our net sales. Although we have secured or are in the process of securing protection for our trademarks and domain names in a number of countries outside of the United States, there are certain countries where we do not currently have or where we do not currently intend to apply for protection for certain trademarks or at all. Also, the efforts we have taken to protect our trademarks may not be sufficient or effective. Therefore, we may not be able to prevent other persons from using our trademarks or domain names outside of the United States, which also could adversely affect our business. We are also subject to the risk that we may infringe on the intellectual property rights of third parties. Any infringement or other intellectual property claim made against us, whether or not it has merit, could be time-consuming, result in costly litigation, cause product delays or require us to pay royalties or license fees. As a result, any such claim could have a material adverse effect on our operating results.

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

Substantially all of our stores are located in shopping malls. Any threat of terrorist attacks or actual terrorist events, particularly in public areas, could lead to lower customer traffic in shopping malls. In addition, local authorities or mall management could close shopping malls in response to security concerns. Mall closures, as well as lower customer traffic due

to security concerns, would likely result in decreased sales. Additionally, the armed conflicts in the Middle East, or the threat, escalation or commencement of war or other armed conflict elsewhere, could significantly diminish consumer spending, and result in decreased sales for us. Decreased sales would have a material adverse effect on our business, financial condition and results of operations.

The outcome of litigation could have a material adverse effect on our business, and may result in substantial costs and could divert management s attention.

We are involved, from time to time, in litigation incidental to our business including complaints filed by investors. This litigation could result in substantial costs, and could divert management s attention and resources, which could harm our business. Risks associated with legal liability are often difficult to assess or quantify, and their existence and magnitude can remain unknown for significant periods of time. There can be no assurance that the actual outcome of pending or future litigation will not have a material adverse effect on our results of operations or financial condition. Additionally, while we maintain director and officer insurance for litigation surrounding investor lawsuits, the amount of insurance coverage may not be sufficient to cover a claim and the continued availability of this insurance cannot be assured.

Our operations expose us to the risk of litigation, which could lead to significant potential liability and costs that could harm our business, financial condition or results of operations.

We employ a substantial number of full-time and part-time employees, a majority of whom are employed at our store locations. As a result, we are subject to a large number of federal and state laws and regulations relating to employment. This creates a risk of potential claims that we have violated laws related to discrimination and harassment, health and safety, wage and hour laws, criminal activity, personal injury and other claims. We are also subject to other types of claims in the ordinary course of our business. Some or all of these claims may give rise to litigation, which could be time-consuming for our management team, costly and harmful to our business.

In addition, we are exposed to the risk of class action litigation. The costs of defense and the risk of loss in connection with class action suits are greater than in single-party litigation claims. Due to the costs of defending against such litigation, the size of judgments that may be awarded against us, and the loss of significant management time devoted to such litigation, we cannot assure you that such litigation will not disrupt our business or impact our financial results.

Our failure to comply with federal, state or local laws, or changes in these laws, could have an adverse impact on our results of operations and financial performance.

Our business is subject to a wide array of laws and regulations. Changes in the regulations, the imposition of additional regulations, or the enactment of any new legislation including those related to health care, taxes, environmental issues and trade, could adversely affect our results of operations or financial condition.

Recent federal health care legislation could increase our expenses.

We are self-insured with respect to our health care coverage and do not purchase third party insurance for the health insurance benefits provided to employees with the exception of pre-defined stop loss, which helps limit the cost of large claims. In March 2010, the Patient Protection and Affordable Care Act (the Act) and the Health Care Education Reconciliation Act of 2010 (the Reconciliation Act) were signed into law. The Act, as modified by the Reconciliation Act, includes a large number of health care provisions to take effect over four years, including expanded dependent coverage, incentives for businesses to provide health care benefits, a prohibition on the denial of coverage and denial of claims on pre-existing conditions, a prohibition on limits on essential benefits and other expansions of health care benefits and coverage. The costs of these provisions are expected to be funded by a variety of taxes and fees. Some of the taxes and fees, as well as certain health care changes required by these acts, are expected to result, directly or indirectly, in increased health care costs for us. For example, the prohibition on limits on essential benefits (whereas we currently cap health-related benefits) could result in increased costs to us. At this time, we cannot quantify the impact, if any, that the legislation may have on us due to the changing regulatory environment around this legislation and due to the government s requirement to issue future unknown regulatory rules. There is no assurance that we will be able to absorb and/or pass through the costs of such legislation in a manner that will not adversely impact our results of operations.

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

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

diversion of traffic and sales from our stores;

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

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

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

We completed our initial public offering in May 2005 and we have incurred and could continue to incur significant legal, accounting, insurance and other expenses as a result of being a public company. Rules and regulations implemented by Congress, the SEC and the NASDAQ Global Select Market have required changes in corporate governance practices of public companies. Compliance with these laws could cause us to incur significant costs and expenses, including legal and accounting costs, and could make some compliance activities more time-consuming and negatively impact our financial performance. Additionally, these rules and regulations may make it more expensive for us to obtain director and officer liability insurance. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors or as officers.

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

Reporting obligations as a public company and our anticipated growth are likely to place a considerable strain on our financial and management systems, processes and controls, as well as on our personnel. In addition, we are required to document and test our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 so that our management can certify as to the effectiveness of our internal controls and our independent registered public accounting firm can render an opinion on the effectiveness of our internal control over financial reporting on an annual basis. This process requires us to document our internal controls over financial reporting and to potentially make significant changes thereto, if applicable. As a result, we have incurred and expect to continue to incur substantial expenses to test our financial controls and systems, and we have been and in the future may be required to improve our financial and managerial controls, reporting systems and procedures, to incur substantial expenses to make such improvements and to hire additional personnel. If our management is ever unable to certify the effectiveness of our internal controls or if our independent registered public accounting firm cannot render an opinion on the effectiveness of our internal control over financial reporting, or if material weaknesses in our internal controls are ever identified, we could be subject to regulatory scrutiny and a loss of public confidence, which could have a material adverse effect on our business and our stock price. In addition, if we do not maintain adequate financial and management personnel, processes and controls, we may not be able to accurately report our financial performance on a timely basis, which could cause a decline in our stock price and adversely affect our ability to raise capital.

Changes to accounting rules or regulations could significantly affect our financial results.

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). New accounting rules or regulations and changes to existing accounting rules or regulations have occurred and may occur in the future. Future changes to accounting rules or regulations, such as changes to lease accounting guidance or a requirement to convert to international financial reporting standards, could negatively affect our results of operations and financial condition through increased cost of compliance.

The security of our databases that contain personal information of our retail customers could be breached, which could subject us to adverse publicity, litigation and expenses. In addition, if we are unable to comply with security standards created by the credit card industry, our operations could be adversely affected.

Database privacy, network security and identity theft are matters of growing public concern. In an attempt to prevent unauthorized access to our network and databases containing confidential, third-party information, we have installed privacy protection systems, devices and activity monitoring on our network. Nevertheless, if unauthorized parties gain access to our networks or databases, they may be able to steal, publish, delete or modify our private and sensitive third-party information. In such circumstances, we could be held liable to our customers or other parties or be subject to regulatory or other actions for

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breaching privacy rules. This could result in costly investigations and litigation, civil or criminal penalties and adverse publicity that could adversely affect our financial condition, results of operations and reputation. Further, if we are unable to comply with the security standards established by banks and the credit card industry, we may be subject to fines, restrictions and expulsion from card acceptance programs, which could adversely affect our retail operations.

We may fail to meet analyst expectations, which could cause the price of our stock to decline.

Our common stock is traded publicly and various securities analysts follow our financial results and issue reports on us. These reports include information about our historical financial results as well as the analysts estimates of our future performance. The analysts estimates are based upon their own independent opinions and can be different from our estimates or expectations. If our operating results are below the estimates or expectations of public market analysts and investors, our stock price could decline. In December 2007, a securities class action litigation and associated derivative lawsuits was brought against us and such actions are frequently brought against other companies following a decline in the market price of their securities. These lawsuits were dismissed with prejudice in March 2009. If our stock price is volatile, we may become involved in this type of litigation in the future. Any litigation could result in substantial costs and a diversion of management s attention and resources that are needed to successfully run our business.

The value of our investments may fluctuate.

We have our excess cash primarily invested in state and local municipal securities, U.S. Treasury securities, U.S. Agency securities and variable-rate demand notes. These investments have historically been considered very safe investments with minimal default rates. At July 30, 2011, we had $114.7 million of investments in state and local government securities and variable-rate demand notes, excluding our auction rate security. These securities are not guaranteed by the United States government and are subject to additional credit risk based upon each local municipality s tax revenues and financial stability. As a result, we may experience a reduction in value or loss of liquidity of our investments, which may have a negative adverse effect on our results of operations, liquidity and financial condition.

The uncertainties in the credit markets have prevented us and other investors from liquidating holdings of auction rate securities in recent auctions for these securities because the amount of securities submitted for sale has exceeded the amount of purchase orders. At July 30, 2011, we had $0.9 million, net of $0.1 million temporary impairment, invested in an auction rate security that is included in long-term investments on the condensed consolidated balance sheet. We may incur impairment charges on this investment in the future.

In addition, in fiscal 2010 we made a $2.0 million equity investment in a manufacturer and expect the value of this investment to increase. However, we do not have control over this investment and it may encounter unanticipated operating issues or negative financial performance that could adversely impact the value of our investment.

A decline in the market price of our stock and our performance may trigger an impairment of the goodwill recorded on the condensed consolidated balance sheets.

Goodwill and other intangible assets with indefinite lives is required to be tested for impairment at least annually or more frequently if management believes indicators of impairment exist. Any reduction in the carrying value of our goodwill as a result of our impairment analysis could result in a non-cash goodwill impairment charge to our statement of operations. A goodwill impairment charge could have a significant impact on earnings and potentially result in a violation of our financial covenants, thereby limiting our ability to secure short-term financing.

Changes to estimates related to our fixed assets, or operating results that are lower than our current estimates at certain store locations, may cause us to incur non-cash impairment charges.

We make certain estimates and projections in connection with impairment analyses for our store locations and other property and equipment. These calculations require us to make a number of estimates and projections of future results. If these estimates or projections change or prove incorrect, we may be required to record impairment charges on certain store locations and other property and equipment. If these impairment charges are significant, our operating results would be adversely affected and our bank covenants may be violated.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

Our market risk profile at July 30, 2011 has not significantly changed since January 29, 2011. Our market risk profile at January 29, 2011 is disclosed in our Annual Report on Form 10-K.

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Item 4: Controls and Procedures

Evaluation of Disclosure Controls and Procedures. We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer (CEO), who is also currently the acting Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Securities Exchange Act Rule 13a-15(e)). Based on this evaluation, our CEO concluded that, as of July 30, 2011, our disclosure controls and procedures were effective.

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

Changes in Internal Control over Financial Reporting. There has been no change in our internal control over financial reporting (as defined in Securities Exchange Act Rule 13a-15(f)) during the quarter ended July 30, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We are involved from time to time in litigation incidental to our business. We are unable to predict the outcome of litigated cases. A court determination in any of litigation actions against us could result in significant liability and could have a material adverse effect on our business, results of operations or financial condition.

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

Item 1A. Risk Factors

Please refer to the Risk Factors set forth in Item 2 of Part I of this Form 10-Q as well as the risk factors previously disclosed in Item 1A of Part I of our Annual Report on Form 10-K for the year ended January 29, 2011. There have been no material changes in the risk factors set forth in our Annual Report on Form 10-K for the year ended January 29, 2011.

Item 2. Unregistered Sales of Equity and Use of Proceeds

The following table presents information with respect to purchases of common stock of the Company made during the thirteen weeks ended July 30, 2011.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
May 1, 2011 May 28, 2011	67	$ 30.28		
May 29, 2011 July 2, 2011		$		
July 3, 2011 July 30, 2011		$		
Total	67			

(1) During the thirteen weeks ended July 30, 2011, 67 shares were either forfeited or purchased by us in order to satisfy employee tax withholding obligations upon the vesting of restricted stock. These shares were not acquired pursuant to any publicly announced purchase plan or program.

Item 3. Defaults Upon Senior Securities

None

Item 4. (Removed and Reserved)

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Item 5. Other Information

None

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Item 6. Exhibits

Exhibit No.	Description of Exhibits
10.18	Credit Agreement, including Revolving Line of Credit Note, with Wells Fargo Bank, N.A. dated August 29, 2011 (incorporated by reference from Exhibit 10.18 to the Form 8-K filed by the Company on August 31, 2011)
31.1	Certification of the Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications of the Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350
101	The following materials from Zumiez Inc. s Quarterly Report on Form 10-Q for the quarterly period ended July 30, 2011, formatted in XBRL (eXtensible Business Reporting Language):
	(i) Condensed Consolidated Balance Sheets at July 30, 2011 and January 29, 2011; (ii) Condensed Consolidated Statements of Operations for the three and six months ended July 30, 2011 and July 31, 2010; (iii) Condensed Consolidated Statements of Changes in Shareholders Equity for the six months ended July 30, 2011 and July 31, 2010; (iv) Condensed Consolidated Statements of Cash Flows for the six months ended July 30, 2011 and July 31, 2010; and (v) Notes to Condensed Consolidated Financial Statements. (1)

(1) The XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section and shall not be incorporated by reference into any filing or other document pursuant to the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing or document.

SIGNATURE

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

ZUMIEZ INC.

Dated: September 1, 2011

By: /s/ MARC D. STOLZMAN

Marc D. Stolzman
Chief Financial Officer and Secretary
(Principal Financial Officer and Principal Accounting Officer)

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