

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 3, 2005

OR

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

For the transition period from _____ to _____

Commission file number: 000-49850

BIG 5 SPORTING GOODS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

95-4388794

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

2525 East El Segundo Boulevard
El Segundo, California

(Address of Principal Executive Offices)

90245

(Zip Code)

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

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

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

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

There were 22,677,627 shares of common stock, with a par value of \$0.01 per share outstanding at September 23, 2005.

BIG 5 SPORTING GOODS CORPORATION

INDEX

PART I – FINANCIAL INFORMATION

Item 1 Financial Statements

[Unaudited Condensed Consolidated Balance Sheets at July 3, 2005 and January 2, 2005](#)

3

[Unaudited Condensed Consolidated Statements of Operations for the Thirteen and Twenty-Six Weeks Ended July 3, 2005 and June 27, 2004 \(restated\)](#)

4

[Unaudited Condensed Consolidated Statements of Cash Flows for the Twenty-Six Weeks Ended July 3, 2005 and June 27, 2004 \(restated\)](#)

5

[Notes to Unaudited Condensed Consolidated Financial Statements](#)

6

Item 2 [Management's Discussion and Analysis of Financial Condition and Results of Operations](#)

12

Item 3	Quantitative and Qualitative Disclosures About Market Risk	31
Item 4	Controls and Procedures	32
<u>PART II – OTHER INFORMATION</u>		
Item 1	Legal Proceedings	36
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	36
Item 3	Defaults Upon Senior Securities	36
Item 4	Submission of Matters to a Vote of Security Holders	37
Item 5	Other Information	37
Item 6	Exhibits	37
<u>SIGNATURES</u>		38
EX-31.1		
EX-31.2		
EX-31.3		
EX-32.1		
EX-32.2		
EX-32.3		

BIG 5 SPORTING GOODS CORPORATION
Unaudited Condensed Consolidated Balance Sheets
(dollars in thousands)

	July 3, 2005	January 2, 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 7,788	\$ 6,746
Trade and other receivables, net	5,659	7,109
Merchandise inventories, net	220,297	206,213
Prepaid expenses and other current assets	16,096	7,988
Deferred income taxes, net	6,892	9,028
Total current assets	<u>256,732</u>	<u>237,084</u>
Property and equipment, net	78,027	63,837
Deferred income taxes, net	5,774	3,853
Leasehold interest, net	1,297	2,178
Other assets, net	1,157	1,292
Goodwill	4,433	4,433
Total assets	<u>\$347,420</u>	<u>\$312,677</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 99,997	\$ 98,298
Accrued expenses	51,356	57,723
Current portion of capital leases	1,509	1,270
Current portion of long-term debt	6,667	6,667
Total current liabilities	<u>159,529</u>	<u>163,958</u>
Deferred rent	19,661	16,389
Capital leases, less current portion	4,103	3,386
Long-term debt, less current portion	100,464	74,668
Total liabilities	<u>283,757</u>	<u>258,401</u>
Stockholders' equity:		
Common stock, \$0.01 par value. Authorized 50,000,000 shares; 22,677,627 shares and 22,677,427 shares issued and outstanding at July 3, 2005 and January 2, 2005, respectively.	227	227
Additional paid-in capital	84,232	84,231
Accumulated deficit	(20,796)	(30,182)
Net stockholders' equity	<u>63,663</u>	<u>54,276</u>
Total liabilities and stockholders' equity	<u>\$347,420</u>	<u>\$312,677</u>

See accompanying notes to unaudited condensed consolidated financial statements.

BIG 5 SPORTING GOODS CORPORATION
Unaudited Condensed Consolidated Statements of Operations
(in thousands, except per share data)

	13 Weeks Ended		26 Weeks Ended	
	July 3, 2005	June 27, 2004 (restated)	July 3, 2005	June 27, 2004 (restated)
Net sales	\$ 198,132	\$ 184,673	\$ 388,231	\$ 366,622
Cost of goods sold, buying and occupancy, excluding depreciation and amortization shown separately below	<u>125,683</u>	<u>116,611</u>	<u>247,954</u>	<u>230,330</u>
Gross profit	<u>72,449</u>	<u>68,062</u>	<u>140,277</u>	<u>136,292</u>
Operating expenses:				
Selling and administrative	57,529	50,015	110,180	100,351
Depreciation and amortization	<u>3,486</u>	<u>2,895</u>	<u>6,934</u>	<u>5,859</u>
Total operating expenses	<u>61,015</u>	<u>52,910</u>	<u>117,114</u>	<u>106,210</u>
Operating income	11,434	15,152	23,163	30,082
Premium and unamortized financing fees related to redemption of debt	—	792	—	792
Interest expense, net	<u>1,283</u>	<u>1,638</u>	<u>2,424</u>	<u>3,574</u>
Income before income taxes	10,151	12,722	20,739	25,716
Income taxes	<u>4,005</u>	<u>5,010</u>	<u>8,179</u>	<u>10,128</u>
Net income available to common stockholders	<u>\$ 6,146</u>	<u>\$ 7,712</u>	<u>\$ 12,560</u>	<u>\$ 15,588</u>
Dividends per share declared:	<u>\$ 0.07</u>	<u>\$ —</u>	<u>\$ 0.14</u>	<u>\$ —</u>
Earnings per share:				
Basic	<u>\$ 0.27</u>	<u>\$ 0.34</u>	<u>\$ 0.55</u>	<u>\$ 0.69</u>
Diluted	<u>\$ 0.27</u>	<u>\$ 0.34</u>	<u>\$ 0.55</u>	<u>\$ 0.68</u>
Weighted average shares of common stock outstanding:				
Basic	<u>22,678</u>	<u>22,668</u>	<u>22,678</u>	<u>22,666</u>
Diluted	<u>22,802</u>	<u>22,794</u>	<u>22,808</u>	<u>22,792</u>

BIG 5 SPORTING GOODS CORPORATION
Unaudited Condensed Consolidated Statements of Cash Flows
(in thousands)

	26 Weeks Ended	
	July 3, 2005	June 27, 2004 (restated)
Cash flows from operating activities:		
Net income	\$ 12,560	\$ 15,588
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,934	5,859
Amortization of deferred finance charge and discounts	189	213
Premium and unamortized financing fees related to redemption of debt	—	792
Deferred tax provision	214	(656)
(Gain) / loss on disposal of equipment	(32)	68
Change in operating assets and liabilities:		
Merchandise inventories	(14,084)	(22,367)
Trade and other receivables, net	1,450	5,535
Prepaid expenses and other assets	(8,027)	456
Accounts payable	5,121	4,510
Accrued expenses and deferred rent	(3,095)	(12,743)
Net cash provided by (used in) operating activities	<u>1,230</u>	<u>(2,745)</u>
Cash flows from investing activities		
Proceeds from sale of equipment	32	0
Purchase of property and equipment	(18,661)	(3,419)
Net cash used in investing activities	<u>(18,629)</u>	<u>(3,419)</u>
Cash flows from financing activities:		
Net borrowings under revolving credit facilities and bank overdraft	22,376	19,060
Principal payments on capital leases	(761)	—
Issuance of common stock, net of repurchases	1	57
Repayment of 10.875% senior notes	—	(15,548)
Cash dividends	(3,175)	—
Net cash provided by financing activities	<u>18,441</u>	<u>3,569</u>
Net increase (decrease) in cash and cash equivalents	1,042	(2,595)
Cash and cash equivalents at beginning of period	<u>6,746</u>	<u>9,030</u>
Cash and cash equivalents at end of period	<u>\$ 7,788</u>	<u>\$ 6,435</u>
Supplemental disclosure of noncash investing activities:		
Property acquired under capital leases	<u>\$ 1,718</u>	<u>\$ —</u>
Supplemental disclosures of cash flow information:		
Interest paid	<u>\$ 2,708</u>	<u>\$ 3,589</u>
Income taxes paid	<u>\$ 13,534</u>	<u>\$ 13,006</u>

See accompanying notes to unaudited condensed consolidated financial statements.

BIG 5 SPORTING GOODS CORPORATION

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Basis of Presentation and Description of Business

Business

Big 5 Sporting Goods Corporation (“we” or the “Company”) is a leading sporting goods retailer operating 311 stores in 10 western states at July 3, 2005. The Company provides a full-line product offering in a traditional sporting goods store format that averages approximately 11,000 square feet. The Company’s product mix includes athletic shoes, apparel and accessories, as well as a broad selection of outdoor and athletic equipment for team sports, fitness, camping, hunting, fishing, tennis, golf, snowboarding and in-line skating. The Company is a holding company that operates its business through Big 5 Corp., its wholly owned subsidiary, and Big 5 Services Corp., which is a wholly owned subsidiary of Big 5 Corp. Big 5 Services Corp. began operations at the beginning of fiscal 2004 to centralize the issuance and administration of gift certificates and gift cards.

The accompanying unaudited condensed consolidated financial statements of the Company and its wholly-owned subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and are presented in accordance with the requirements of Form 10-Q. Accordingly, these unaudited condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended January 2, 2005. In the opinion of management, the unaudited condensed consolidated financial statements included herein contain all adjustments considered necessary for a fair presentation of the Company’s financial position, the results of operations and cash flows for the periods presented.

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

Principles of Consolidation

The unaudited condensed consolidated financial statements include the accounts of all wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Segment Reporting

Given the economic characteristics of our store formats, the similar nature of the products sold, the type of customer and method of distribution, our operations are aggregated in one reportable segment as defined by SFAS No. 131, *Disclosure About Segments of an Enterprise and Related Information*.

Table of Contents

Use of Estimates

Management of the Company has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period to prepare these financial statements in conformity with GAAP. Significant items subject to such estimates and assumptions include the carrying amount of property and equipment, intangibles and goodwill; valuation allowances for receivables, sales returns, inventories and deferred income tax assets; and obligations related to litigation, workers compensation and employee benefits. Actual results could differ from these estimates.

Fiscal Year

The Company follows the concept of a 52-53 week fiscal year, which ends on the Sunday nearest December 31. Fiscal year 2005 is comprised of 52 weeks and ends on January 1, 2006. Fiscal year 2004 was comprised of 53 weeks and ended on January 2, 2005. The fiscal interim periods ended July 3, 2005 and April 3, 2005 and June 27, 2004 and March 28, 2004 were comprised of 13 weeks.

Reclassifications

Certain prior period amounts have been reclassified to conform to the present year presentation.

Stock-Based Compensation

Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation*, and SFAS No. 148, *Accounting for Stock-Based Compensation — Transition and Disclosure, an amendment to FASB Statement No. 123*, established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based compensation plans. As permitted by existing accounting standards, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123, as amended. Had the Company determined compensation cost based upon the fair value at the grant date for its stock options using the Black Scholes option pricing model, pro forma net income and pro forma net income per share, including the following weighted average assumptions used in these calculations, would have been as follows:

[Table of Contents](#)

	13 Weeks Ended		26 Weeks Ended	
	July 3, 2005	June 27, 2004 (restated)	July 3, 2005	June 27, 2004 (restated)
Net income, as reported	\$ 6,146	\$ 7,712	\$ 12,560	\$ 15,588
Deduct: Total stock-based employee compensation expense determined under fair value based methods for all awards, net of related tax effects	234	227	469	378
Pro forma net income	<u>\$ 5,912</u>	<u>\$ 7,485</u>	<u>\$ 12,091</u>	<u>\$ 15,210</u>
Earnings per share:				
Basic — as reported	\$ 0.27	\$ 0.34	\$ 0.55	\$ 0.69
Basic — pro forma	\$ 0.26	\$ 0.33	\$ 0.53	\$ 0.67
Diluted — as reported	\$ 0.27	\$ 0.34	\$ 0.55	\$ 0.68
Diluted — pro forma	\$ 0.26	\$ 0.33	\$ 0.53	\$ 0.67
Weighted average assumptions:				
Risk free interest rate	2.8%	2.8%	2.8%	2.8%
Expected lives	4 years	4 years	4 years	4 years
Expected volatility	60%	60%	60%	60%
Expected dividends	—	—	—	—

In the fourth quarter of fiscal 2004 the Company declared a cash dividend, at an annual rate of \$0.28 per share of outstanding common stock. The first quarterly payment, of \$0.07 per share, was paid on December 15, 2004, to stockholders of record as of December 1, 2004. The majority of options issued by the Company were granted prior to the initiation of a dividend. As a result, the weighted average dividend assumption used in valuing options granted was less than \$0.01 per share.

(2) Restatement

The Company has restated the consolidated balance sheet at December 28, 2003 and the consolidated statements of operations, the consolidated statements of stockholders' equity and the consolidated statements of cash flows for the fiscal years ended December 29, 2002 and December 28, 2003 in the Annual Report on Form 10-K for the fiscal year ended January 2, 2005. The Company also has restated its quarterly financial information for fiscal 2003 and the first three interim periods of fiscal 2004. The net effect of the restatement was to reduce net income by \$1.8 million and \$2.9 million in fiscal years 2002 and 2003, respectively, to increase reported net income in the first three quarters of fiscal 2004 by \$1.4 million and to reduce retained earnings by \$3.2 million at the beginning of fiscal year 2002 to reflect the after-tax impact of the restatement in prior periods.

Table of Contents

The following is a summary of the effects of the restatement on our unaudited condensed consolidated statements of operations for the 13 and 26 weeks ended June 27, 2004. The restatement had no impact on net cash flows from operating, investing and financing activities during the 26 weeks ended June 27, 2004.

	13 weeks ended June 27, 2004			26 weeks ended June 27, 2004		
	Previously Reported	Adjustments	Restated (in thousands, except per share data)	Previously Reported	Adjustments	Restated
Net sales	\$ 184,487	\$ 186	\$ 184,673	\$ 365,492	\$ 1,130	\$ 366,622
Cost of goods sold, buying and occupancy	116,806	(195)	116,611	232,172	(1,842)	230,330
Gross profit	67,681	381	68,062	133,320	2,972	136,292
Operating expenses:						
Selling and administrative	50,035	(20)	50,015	99,615	736	100,351
Depreciation and amortization	2,711	184	2,895	5,502	357	5,859
Total operating expenses	52,746	164	52,910	105,117	1,093	106,210
Operating income	14,935	217	15,152	28,203	1,879	30,082
Premium and unamortized financing fees related to redemption of debt	792	—	792	792	—	792
Interest expense, net	1,638	—	1,638	3,574	—	3,574
Income before income taxes	12,505	217	12,722	23,837	1,879	25,716
Income taxes	5,001	9	5,010	9,534	594	10,128
Net income available to common stockholders	\$ 7,504	\$ 208	\$ 7,712	\$ 14,303	\$ 1,285	\$ 15,588
Earnings per share:						
Basic	\$ 0.33	\$ 0.01	\$ 0.34	\$ 0.63	\$ 0.06	\$ 0.69
Diluted	\$ 0.33	\$ 0.01	\$ 0.34	\$ 0.63	\$ 0.05	\$ 0.68

(3) Quarterly Dividend

In the fourth quarter of fiscal 2004, the Company declared a cash dividend, at an annual rate of \$0.28 per share of outstanding common stock. Quarterly dividend payments of \$0.07 per share were paid on December 15, 2004, March 15, 2005, June 15, 2005 and September 15, 2005 to stockholders of record as of December 1, 2004, March 1, 2005, June 1, 2005 and September 1, 2005, respectively.

(4) Debt Redemption

In the second quarter of fiscal 2004 the Company redeemed \$15.0 million face value of its 10.875% senior notes due 2007 using borrowings under its revolving credit facility.

[Table of Contents](#)

The Company also redeemed the remaining \$33.1 million face value of its 10.875% senior notes due 2007 during the fourth quarter of fiscal 2004 using borrowings under its financing agreement.

(5) Earnings Per Share

Basic earnings per share is calculated by dividing net income available to common stockholders by the weighted average of common shares outstanding during the period. Diluted earnings per share is calculated by using the weighted average of common shares outstanding adjusted to include the potentially dilutive effect of outstanding stock options.

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

	13 weeks ended		26 weeks ended	
	July 3, 2005	June 27, 2004 (restated)	July 3, 2005	June 27, 2004 (restated)
Income available to common stockholders	<u>\$ 6,146</u>	<u>\$ 7,712</u>	<u>\$ 12,560</u>	<u>\$ 15,588</u>
Weighted average shares of common stock outstanding:				
Basic	22,678	22,668	22,678	22,666
Dilutive effect of common stock options	124	126	130	126
Diluted	<u>22,802</u>	<u>22,794</u>	<u>22,808</u>	<u>22,792</u>
Basic earnings per share	<u>\$ 0.27</u>	<u>\$ 0.34</u>	<u>\$ 0.55</u>	<u>\$ 0.69</u>
Diluted earnings per share	<u>\$ 0.27</u>	<u>\$ 0.34</u>	<u>\$ 0.55</u>	<u>\$ 0.68</u>

The computation of diluted earnings for the 13 weeks ended July 3, 2005, the 26 weeks ended July 3, 2005 and the 26 weeks ended June 27, 2004 does not include 2,500, 2,500, and 341,400 options, respectively, that were outstanding on those dates. The exercise price of these options was greater than the average market price of the Company's common stock during the relevant reporting periods and thus would have been antidilutive.

(6) Contingencies

On August 12, 2005, the Company was served with a complaint filed in the California Superior Court in the County of Los Angeles, entitled William Childers v. Sandra N. Bane, et al., Case No. BC337945 ("*Childers*"), alleging breach of fiduciary duty, violation of the Company's bylaws and unjust enrichment by certain executive officers. This complaint was brought both as a purported stockholder class action and as a purported derivative action on behalf of the Company against all of the members of the Company's board of directors and certain executive officers. The complaint alleges that the Company's directors breached their fiduciary duties and violated the Company's bylaws by, among other things, failing to hold an annual stockholders' meeting on a timely basis and allegedly

Table of Contents

ignoring certain unspecified internal control problems, and that certain executive officers were unjustly enriched by their receipt of certain compensation items. The complaint seeks an order requiring that an annual meeting of our stockholders be held, an award of unspecified damages in favor of the Company and against the individual defendants and an award of attorneys' fees. The Company believes that the complaint is without merit and intends to defend the suit vigorously. An adverse result in this litigation could harm the Company's financial condition and results of operations, and the costs of defending this litigation could have a negative impact on the Company's results of operations. The Company has indemnification agreements with each of its directors and executive officers. These agreements, among other things, provide for indemnification of the Company's directors and executive officers for expenses, judgments, fines and settlement amounts incurred by any such person in any action or proceeding arising out of such person's services as a director or executive officer or at our request, including as a result of this complaint, if the applicable director or executive officer acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Company.

In addition, the Company is from time to time involved in routine litigation incidental to the conduct of its business. The Company believes that no other litigation currently pending against it will have a material adverse impact on its business, financial position or results of operations. The Company may enter into discussions regarding settlement of lawsuits to which it is a party if it believes settlement is in the best interests of the Company and its stockholders. In accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," the Company has made accruals with respect to these lawsuits, where appropriate, which are reflected in the Company's unaudited condensed consolidated financial statements.

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

BASIS OF REPORTING

Net Sales

Net sales consist of sales from all stores operated during the period presented, net of estimated merchandise returns. Net sales also include the sale of returned merchandise to vendors specializing in the resale of defective or used products, which historically has accounted for less than 1% of net sales. Same store sales for a period reflect net sales from stores operated throughout that period as well as the corresponding prior period, i.e., two complete fiscal years for annual comparisons and complete current and prior year fiscal quarters for quarterly comparisons. New store sales for a period reflect net sales from stores opened in that period as well as net sales from stores opened during the prior fiscal year. Stores that are relocated during any period are treated as new stores, with sales from the prior location being treated as sales from a closed store. Cash received from the sale of gift cards is recorded as a liability, and revenue is recognized upon the redemption of the gift card. Installment payments on layaway sales are recorded as a liability, and revenue is recognized upon receipt of final payment from and delivery to the customer.

Gross Profit

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

Selling and Administrative

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

Depreciation and Amortization

Depreciation and amortization consists primarily of the depreciation of leasehold improvements, fixtures and equipment owned by us.

DISCUSSION OF CRITICAL ACCOUNTING POLICIES

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

Valuation of Inventory

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

Valuation of Long-Lived Assets

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

Revenue Recognition

We earn revenue by selling merchandise primarily through our retail stores. Also included in revenue are sales of returned merchandise to vendors specializing in the resale of defective or used products, which historically has accounted for less than 1% of net sales. Revenue is recognized when merchandise is purchased by and delivered to the customer and is shown net of estimated returns during the relevant period. The allowance for sales returns is estimated based upon historical experience. Cash received from the sale of gift cards is recorded as a liability, and revenue is recognized upon the redemption of the gift card. Installment payments on layaway sales are recorded as a liability, and revenue is recognized upon receipt of final payment from and delivery to the customer.

[Table of Contents](#)

Income Taxes

We account for income taxes under the asset and liability method whereby deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The realizability of deferred tax assets is assessed throughout the year and a valuation allowance is recorded if necessary to reduce net deferred tax assets to an amount whose realization is more likely than not.

Leases

We lease substantially all of our store locations. We account for our leases under the provisions of SFAS No. 13, *Accounting for Leases*, and subsequent amendments, which require that our leases be evaluated and classified as operating or capital leases for financial reporting purposes.

Certain leases have scheduled rent increases. In addition, certain leases include an initial period of free or reduced rent as an inducement to enter into the lease agreement (“rent holidays”). The Company recognizes rental expense for rent escalations and rent holidays on a straight-line basis over the terms of the underlying leases, without regard to when rent payments are made. The calculation of straight-line rent is based on the reasonably assured lease term as defined in SFAS No. 98, *Accounting for Leases*, which may exceed the initial non-cancelable lease term.

Certain leases also may provide for payments based on future sales volumes at the leased location, which are not measurable at the inception of the lease. In accordance with SFAS No. 29, *Determining Contingent Rentals, an amendment of FASB Statement No. 13*, these contingent rents are expensed as they accrue.

Self-Insurance Liabilities

We maintain self-insurance programs for general liability and a portion of our workers’ compensation liability risks. We are self-insured up to specified per-occurrence limits and maintain insurance coverage for losses in excess of specified amounts. Estimated costs under these programs, including incurred but not reported claims, are recorded as expenses based upon historical experience, trends of paid and incurred claims, and other actuarial assumptions. If actual claims trends, including the severity or frequency of claims, differ from our estimates, our financial results could be significantly impacted.

Segment Reporting

Given the economic characteristics of our store formats, the similar nature of the products sold, the type of customer and method of distribution, our operations are aggregated in one reportable segment as defined by SFAS No. 131, *Disclosure About Segments of an Enterprise and Related Information*.

RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

We have restated the consolidated balance sheet at June 27, 2004, and the consolidated statements of operations and cash flows for the 13 and 26 weeks ended June 27, 2004 in this Quarterly Report on Form 10-Q. This Management's Discussion and Analysis of Financial Condition and Results of Operations on and for the 13 and 26 weeks ended June 27, 2004 have been modified and updated to reflect the effects of the restatement. See Note 2 to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended January 2, 2005 and Note 2 to the unaudited condensed consolidated financial statements in Item 1 "Financial Statements" of this Quarterly Report on Form 10-Q for additional information on the restatement.

RESULTS OF OPERATIONS

The results of the interim periods are not necessarily indicative of results for the entire fiscal year.

13 Weeks Ended July 3, 2005 Compared to 13 Weeks Ended June 27, 2004

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

	13 Weeks Ended		June 27, 2004	
	July 3, 2005	(unaudited)	(restated)	
Net sales	\$ 198,132	100.0%	\$ 184,673	100.0%
Cost of goods sold	125,683	63.4	116,611	63.1
Gross profit	72,449	36.6	68,062	36.9
Operating expenses:				
Selling and administrative	57,529	29.0	50,015	27.1
Depreciation and amortization	3,486	1.8	2,895	1.6
Total operating expenses	61,015	30.8	52,910	28.7
Operating income	11,434	5.8	15,152	8.2
Premium and unamortized financing fees related to redemption of debt	—	0.0	792	0.4
Interest expense, net	1,283	0.6	1,638	0.9
Income before income taxes	10,151	5.1	12,722	6.9
Income taxes	4,005	2.0	5,010	2.7
Net income	\$ 6,146	3.1%	\$ 7,712	4.2%

Net Sales. Net sales increased by \$13.4 million, or 7.3%, to \$198.1 million in the 13 weeks ended July 3, 2005 from \$184.7 million in the same period last year. The growth in net sales is attributable to an increase of \$7.0 million in same store sales and an increase of \$6.3 million in new store sales, net of sales for closed stores, which reflected the opening of 17 new stores, net of relocations, since March 28, 2004. Same store sales increased 3.8% in

Table of Contents

the 13 weeks ended July 3, 2005 versus the 13 weeks ended June 27, 2004. On a calendar day to calendar day basis, same store sales increased 2.6% during the second quarter of fiscal 2005. We are providing information regarding same store sales on a calendar day to calendar day basis in addition to a period to period basis because of the calendar shift in the fiscal quarters associated with fiscal 2004 being a 53-week year and fiscal 2005 being a 52-week year. The total net sales increase was due to a combination of an increase in the number of sales transactions and a slight increase in transaction size. Store count at July 3, 2005 was 311 versus 295 at June 27, 2004. We opened three stores, one of which was a relocation, in the 13 weeks ended July 3, 2005, and one store in the 13 weeks ended June 27, 2004. We expect to open between 15 and 17 net new stores during fiscal 2005.

Gross Profit. Gross profit increased by \$4.3 million, or 6.4%, to \$72.4 million in the 13 weeks ended July 3, 2005 from \$68.1 million in the same period last year. The gross profit margin was 36.6% in the 13 weeks ended July 3, 2005 compared to 36.9% in the same period last year. Product selling margins, which exclude buying, occupancy and distribution costs, increased 0.1% versus the prior period. Distribution center costs increased \$1.7 million, or 0.9% of net sales, due primarily to the commencement of rental payments for our new distribution center, higher payroll-related costs and increased trucking expense reflecting higher gasoline prices. Store occupancy costs also increased by \$1.1 million year-over-year due mainly to new store openings. These higher expenses were partially offset by an increase of \$0.4 million in cost capitalized into inventory for the second quarter of 2005 compared to the prior year. Also, in the 13 weeks ended July 3, 2005 we received \$0.4 million in insurance reimbursement related to flood damage to one of our stores which occurred in the first quarter of fiscal 2005.

Selling and Administrative. Selling and administrative expenses increased by \$7.5 million to \$57.5 million, or 29.0% of net sales, in the 13 weeks ended July 3, 2005 from \$50.0 million, or 27.1% of net sales, in the same period last year. The increase was driven by a \$1.9 million increase in legal and audit fees for the second quarter of this year, due primarily to costs related to the restatement of our prior period financial statements (see footnote 2, "Restatement"). Store-related expenses, excluding occupancy, increased by \$3.0 million during the second quarter, due primarily to an increase in store count and higher labor and benefit costs. Workers compensation expense increased compared to the corresponding period in the prior year due mainly to the reimbursement of excess insurance claims in the second quarter of fiscal 2004. Advertising expense increased by \$1.1 million, due mainly to the growth in our store base since the same period last year and a shift in the timing of July 4th holiday advertising into this year's second quarter. The remaining increase was a result of various higher administrative expenses, including \$0.5 million in accrual adjustments relating to employee bonuses for fiscal 2005.

Depreciation and Amortization. Depreciation and amortization expense increased \$0.6 million, or 20.4%, to \$3.5 million for the 13 weeks ended July 3, 2005 from \$2.9 million for the same period last year. The higher expense was primarily due to the increase in store count to 311 stores at the end of the second quarter of fiscal 2005 from 295 stores at the end of the second quarter of fiscal 2004

Premium and Unamortized Financing Fees Related to Redemption of Debt. There were no premium and unamortized financing fees related to redemption of debt in the 13 weeks ended July 3, 2005. Premium and unamortized financing fees related to redemption of debt were \$0.8 million in the 13 weeks ended June 27, 2004. The \$0.8 million charge in

[Table of Contents](#)

the second quarter of last year resulted from the redemption of \$15.0 million face value of our 10.875% senior notes and the related carrying value of applicable deferred financing costs and original issue discount.

Interest Expense, Net. Interest expense, net decreased by \$0.3 million, or 21.7%, to \$1.3 million in the 13 weeks ended July 3, 2005 from \$1.6 million in the same period last year. Interest expense benefited from the redemption of \$15.0 million face value of our 10.875% senior notes in the second quarter of fiscal 2004 and the remaining \$33.1 million face value of our outstanding 10.875% senior notes in the fourth quarter of fiscal 2004 through borrowings under our lower-cost financing agreement. A reduction in overall debt levels since the beginning of fiscal 2004 also contributed to the decrease in interest expense. Because all of our 10.875% senior notes have now been redeemed, we do not expect that our interest expense will decline as rapidly as it has in recent periods.

Income Taxes. The provision for income taxes was \$4.0 million for the 13 weeks ended July 3, 2005 and \$5.0 million for the 13 weeks ended June 27, 2004. Our effective tax rate was 39.4% for both periods.

26 Weeks Ended July 3, 2005 Compared to 26 Weeks Ended June 27, 2004

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

	26 Weeks Ended		June 27, 2004	
	July 3, 2005	(unaudited)	(restated)	
Net sales	\$ 388,231	100.0%	\$ 366,622	100.0%
Cost of goods sold	247,954	63.9	230,330	62.8
Gross profit	140,277	36.1	136,292	37.2
Operating expenses:				
Selling and administrative	110,180	28.4	100,351	27.4
Depreciation and amortization	6,934	1.8	5,859	1.6
Total operating expenses	117,114	30.2	106,210	29.0
Operating income	23,163	5.9	30,082	8.2
Premium and unamortized financing fees related to redemption of debt	—	0.0	792	0.2
Interest expense, net	2,424	0.6	3,574	1.0
Income before income taxes	20,739	5.3	25,716	7.0
Income taxes	8,179	2.1	10,128	2.8
Net income	<u>\$ 12,560</u>	<u>3.2%</u>	<u>\$ 15,588</u>	<u>4.3%</u>

Table of Contents

Net Sales. Net sales increased by \$21.6 million, or 5.9%, to \$388.2 million in the 26 weeks ended July 3, 2005 from \$366.6 million in the same period last year. The growth in net sales is mainly attributable to an increase of \$9.8 million in same store sales and an increase of \$11.7 million in new store sales, net of the sales for closed stores, which reflected the opening of 18 new stores, net of relocations, since December 28, 2003. Same store sales increased 2.7% in the 26 weeks ended July 3, 2005 versus the 26 weeks ended June 27, 2004. On a calendar day to calendar day basis, same store sales increased 2.2% during the first half of fiscal 2005. We are providing information regarding same store sales on a calendar day to calendar day basis in addition to a period to period basis because of the calendar shift in the fiscal quarters associated with fiscal 2004 being a 53-week year and fiscal 2005 being a 52-week year. The total net sales increase was due to a combination of an increase in the number of sales transactions and a slight increase in transaction size. Store count at July 3, 2005 was 311 versus 295 at June 27, 2004. We opened four stores, including two relocated stores, in each of the 26 weeks ended July 3, 2005 and June 27, 2004. We expect to open between 15 and 17 net new stores during fiscal 2005.

Gross Profit. Gross profit increased by \$4.0 million, or 2.9%, to \$139.9 million in the 26 weeks ended July 3, 2005 from \$136.3 million in the same period last year. The gross profit margin was 36.1% in the 26 weeks ended July 3, 2005 compared to 37.2% in the prior year period. Product selling margins, which exclude buying, occupancy and distribution costs, were unchanged from the same period last year. Inventory provisions, such as those for shrinkage and returned merchandise, increased \$1.5 million, or 0.4% of net sales, from the prior year primarily as a result of the volume of returned goods inventories and related realizability of the value of these returned goods. Distribution center costs increased by \$2.4 million during the period, due primarily to the commencement of rental payments for our new distribution center, higher payroll-related costs and increased trucking expense reflecting higher gasoline prices. Store occupancy costs increased by \$1.9 million over the same period last year, due mainly to new store openings.

Selling and Administrative. Selling and administrative expenses increased by \$9.8 million to \$110.2 million, or 28.4% of net sales, in the 26 weeks ended July 3, 2005 from \$100.4 million, or 27.4% of net sales, in the same period last year. The increase was driven by a \$2.5 million increase in legal and audit fees for the first half of fiscal 2005, due primarily to costs related to the restatement of our prior period financial statements (see footnote 2, "Restatement"). Store-related expenses, excluding occupancy, increased by \$5.1 million during the 26-week period, due primarily to an increase in store count. Advertising expense increased by \$1.3 million due primarily to the growth in our store base since the same period last year.

Depreciation and Amortization. Depreciation and amortization expense increased \$1.0 million, or 18.3%, to \$6.9 million for the 26 weeks ended July 3, 2005 from \$5.9 million for the same period last year. The higher expense this year is primarily due to the increase in store count to 311 stores at the end of the first half of fiscal 2005 from 295 stores at the end of the first half of fiscal 2004.

Table of Contents

Premium and Unamortized Financing Fees Related to Redemption of Debt. There were no premium and unamortized financing fees related to redemption of debt in the 26 weeks ended July 3, 2005 versus \$0.8 million in the 26 weeks ended June 27, 2004. The \$0.8 million charge in the first half of last year resulted from the redemption of \$15.0 million face value of our 10.875% senior notes.

Interest Expense, Net. Interest expense, net decreased by \$1.2 million, or 32.2%, to \$2.4 million in the 26 weeks ended July 3, 2005 from \$3.6 million in the same period last year. Interest expense benefited from the redemption of \$15.0 million face value of our 10.875% senior notes in the second quarter of fiscal 2004 and the remaining \$33.1 million face value in the fourth quarter of fiscal 2004 through borrowings under our lower cost financing agreement. A reduction in overall debt levels since the beginning of fiscal 2004 also contributed to the decrease in interest expense. Because all of our 10.875% senior notes have now been redeemed, we do not expect that our interest expense will decline as rapidly as it has in recent periods.

Income Taxes. The provision for income taxes was \$8.2 million for the 26 weeks ended July 3, 2005 and \$10.1 million for the 26 weeks ended June 27, 2004. Our effective tax rate was 39.4% for both periods.

LIQUIDITY AND CAPITAL RESOURCES

Our principal liquidity requirements are for working capital and capital expenditures. We fund our liquidity requirements with cash on hand, cash flow from operations and borrowings under the revolving credit facility under our financing agreement.

Operating Activities. Net cash provided by (used in) operating activities for the first 26 weeks of fiscal 2005 and fiscal 2004 was \$1.2 million and (\$2.7) million, respectively. The change between periods primarily reflects lower net income in the first half of fiscal 2005 offset by lower working capital requirements. Comparing the first half of fiscal 2005 to the corresponding period in the prior year, the positive cash flow effect of a lower ramp-up in inventory and lower payments from accrued liabilities was offset by a smaller reduction in receivables.

Investing Activities. Net cash used in investing activities represents the purchase of property and equipment. Capital expenditures for the first 26 weeks of fiscal 2005 and fiscal 2004 were \$18.7 million and \$3.4 million, respectively. Expenditures for our planned new distribution center accounted for approximately \$14.1 million of capital expenditures in the first 26 weeks of fiscal 2005. The balance of these expenditures was primarily for store-related remodeling and new store openings.

Financing Activities. Net cash provided by financing activities for the first 26 weeks of fiscal 2005 and fiscal 2004 was \$18.4 million and \$3.6 million, respectively. The increased cash requirement was primarily provided by the revolving credit facility under our

Table of Contents

financing agreement to finance increased working capital and capital expenditures relating to our new distribution center, new store openings, and store remodeling.

In the fourth quarter of fiscal 2004, we declared a cash dividend at an annual rate of \$0.28 per share of outstanding common stock. Quarterly dividend payments of \$0.07 per share were paid on December 15, 2004, March 15, 2005, June 15, 2005 and September 15, 2005 to stockholders of record as of December 1, 2004, March 1, 2005, June 1, 2005 and September 1, 2005, respectively. The aggregate amount of each quarterly dividend was approximately \$1.6 million. Our ability to pay this dividend in the future will depend, in part, on compliance with the restrictions on dividends contained in our financing agreement.

Financing Agreement. As of July 3, 2005, we had revolving credit borrowings of \$87.1 million, a term loan balance of \$20.0 million and letter of credit commitments of \$0.5 million outstanding under our financing agreement. These balances compare to revolving credit borrowings of \$76.5 million and letter of credit commitments of \$0.5 million outstanding under our prior credit facility and \$33.1 million face value of our 10.875% senior notes outstanding as of June 27, 2004. We redeemed \$15.0 million face value of our 10.875% senior notes in the second quarter of fiscal 2004 using borrowings under our revolving credit facility. In addition, we redeemed the remaining \$33.1 million face value of these notes in the fourth quarter of 2004 using borrowings under our financing agreement.

Our financing agreement contains various financial and other covenants, including covenants that require us to maintain various financial ratios, restrict our ability to incur indebtedness or to create various liens and restrict the amount of capital expenditures that we may incur. Our financing agreement also restricts our ability to engage in mergers or acquisitions, sell assets or pay dividends. We are currently in compliance with all covenants under our financing agreement. We have received extensions of time from the lenders under our financing agreement to deliver periodic financial statements as required by the financing agreement.

If we fail to make any required payment under our financing agreement or if we otherwise default under this instrument, our debt may be accelerated under this agreement. This acceleration could also result in the acceleration of other indebtedness that we may have outstanding at that time.

Future Capital Requirements. We had \$7.8 million of cash at July 3, 2005 and \$6.4 million at June 27, 2004. We expect capital expenditures for the remaining 26 weeks of fiscal 2005 to range from \$8 to \$10 million, excluding non-cash acquisitions under capital leases. Approximately \$1 million of these capital expenditures will be related to our new distribution center. Construction has been substantially completed and we have begun the transition to the new distribution center. We anticipate completion of construction early in the fourth quarter of fiscal 2005, with completion of the transition expected in the first quarter of fiscal 2006.

We believe we will be able to fund our future cash requirements for operations from operating cash flows, cash on hand and borrowings under the revolving credit facility under our financing agreement. We believe these sources of funds will be sufficient to continue our operations and planned capital expenditures, satisfy our scheduled payments under debt

Table of Contents

obligations and pay quarterly dividends for at least the next twelve months. However, our ability to satisfy such obligations depends upon our future performance, which in turn is subject to general economic conditions and regional risks, and to financial, business and other factors affecting our operations, including factors beyond our control. See “ Risk Factors That May Affect Future Results and Market Price of Our Common Stock.”

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

Contractual obligations and other commitments. Our material off-balance sheet arrangements are operating lease obligations and letters of credit. We excluded these items from the balance sheet in accordance with GAAP.

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

In April 2004 we signed an operating lease agreement for a new distribution facility in order to facilitate our store growth. The new distribution facility is located in Riverside, California and has approximately 953,132 square feet of storage and office space.

Issued and outstanding letters of credit were \$0.5 million at July 3, 2005, and were related primarily to importing of merchandise and funding insurance program liabilities.

In the ordinary course of business, we enter into arrangements with vendors to purchase merchandise in advance of expected delivery. Because most of these purchase orders do not contain any termination payments or other penalties if cancelled, they are not included as outstanding contractual obligations.

SEASONALITY

We experience seasonal fluctuations in our net sales and operating results. In fiscal 2004, we generated 27.8% of our net sales and 28.8% of our operating income in the fourth fiscal quarter, which includes the holiday selling season as well as the peak winter sports selling season. As a result, we incur significant additional expenses in the fourth fiscal quarter due to higher purchase volumes and increased staffing. If we miscalculate the demand for our products generally or for our product mix during the fourth fiscal quarter, our net sales could decline, resulting in excess inventory, which could harm our financial performance. Because a substantial portion of our operating income is derived from our fourth fiscal quarter net sales, a shortfall in expected fourth fiscal quarter net sales could cause our annual operating results to suffer significantly.

IMPACT OF ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 151, *Inventory Costs — an amendment of ARB No. 43, Chapter 4*. SFAS No. 151 clarifies that abnormal inventory costs are required to be charged to expense as incurred as opposed to being capitalized into inventory as a product cost. SFAS No. 151 provides examples of abnormal inventory costs to include costs of idle facilities, excess freight and handling costs, and wasted materials (spoilage). This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. While we continue to evaluate the impact of SFAS No. 151, we do not believe the adoption of this statement will have a material impact on our consolidated financial statements.

In December 2004, FASB issued SFAS No. 123 (Revised), *Share-Based Payment* (“SFAS No. 123R”). SFAS No. 123R eliminates the intrinsic value method under APB No. 25 as an alternative method of accounting for stock-based awards. SFAS No. 123R also revises the fair value-based method of accounting for share-based payment liabilities, forfeitures and modifications of stock-based awards and clarifies SFAS No. 123’s guidance in several areas, including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. In addition, SFAS No. 123R amends SFAS No. 95, *Statement of Cash Flows*, to require that excess tax benefits be reported as a financing cash inflow rather than as a reduction of taxes paid, which is included within operating cash flows. SFAS No. 123R is effective as of the first annual reporting period beginning after June 15, 2005. We continue to evaluate the impact of SFAS No. 123R on our overall results of operations, financial position and cash flows. Please refer to the pro forma disclosure under “Stock-Based Compensation” in Note 5 in the Notes to Unaudited Condensed Consolidated Financial Statements for an indication of ongoing expense that will be included in the income statement beginning in fiscal 2006 under SFAS No. 123R.

In March 2005, FASB issued Interpretation No. 47 (“FIN No. 47”), *Accounting for Conditional Asset Retirement Obligations*, an interpretation of SFAS No. 143, *Accounting for Asset Retirement Obligations*. FIN No. 47 clarifies that the term conditional asset retirement obligation as used in SFAS No. 143 refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN No. 47 is effective no later than the end of the fiscal year ending after December 15, 2005. Retrospective application for interim financial information is permitted but is not required. We have not yet determined the financial statement impact, if any, of implementing FIN No. 47.

In May 2005, FASB issued SFAS No. 154, *Accounting Changes and Error Corrections, a replacement of Accounting Principles Board Opinion (“APB”) No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements*. This statement requires retrospective application to prior periods’ financial statements of a change in accounting principle. It applies both to voluntary

[Table of Contents](#)

changes and to changes required by an accounting pronouncement if the pronouncement does not include specific transition provisions. APB No. 20 previously required that most voluntary changes in accounting principles be recognized by recording the cumulative effect of a change in accounting principle. SFAS No. 154 is effective for fiscal years beginning after December 15, 2005. We plan to adopt this statement on January 2, 2006 and it is not expected to have a material effect on the financial statements upon adoption.

FORWARD-LOOKING STATEMENTS

This document includes certain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements relate to, among other things, our financial condition, our results of operations, our growth strategy and the business of our company generally. In some cases, you can identify such statements by terminology such as “may”, “will”, “should”, “expects”, “plans”, “anticipates”, “believes”, “intends” or other such terminology. These forward-looking statements involve risks, uncertainties and other factors that may cause our actual results in future periods to differ materially from forecasted results. These risks and uncertainties include, without limitation, the risk factors set forth below and elsewhere in this report and other risks and uncertainties more fully described in our other filings with the SEC. We caution that the risk factors set forth in this report are not exclusive. In addition, we conduct our business in a highly competitive and rapidly changing environment. Accordingly, new risk factors may arise. It is not possible for management to predict all such risk factors, nor to assess the impact of all such risk factors on our business or the extent to which any individual risk factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. We disclaim any obligation to revise or update any forward-looking statement that may be made from time to time by us or on our behalf.

RISK FACTORS THAT MAY AFFECT FUTURE RESULTS AND MARKET PRICE OF OUR COMMON STOCK

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

Risks Related to Our Business

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

We have a substantial amount of debt. As of July 3, 2005, the aggregate principal amount of our outstanding indebtedness was approximately \$107.6 million, including letters of credit. Our leveraged financial position means:

- a substantial portion of our cash flow from operations will be required to service our indebtedness;
- our ability to obtain financing in the future for working capital, capital expenditures and general corporate purposes might be impeded; and
- we are more vulnerable to economic downturns and our ability to withstand competitive pressures is limited.

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

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

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

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

The terms of our financing agreement impose operating and financial restrictions on us, including, among other things, restrictions on our ability to incur additional indebtedness, create or allow liens, pay dividends, engage in mergers, acquisitions or reorganizations or make specified capital expenditures. For example, our ability to engage in the foregoing transactions will depend upon, among other things, our level of indebtedness at the time of the proposed transaction and whether we are in default under our

[Table of Contents](#)

financing agreement. As a result, our ability to respond to changing business and economic conditions and to secure additional financing, if needed, may be significantly restricted, and we may be prevented from engaging in transactions that might further our growth strategy or otherwise benefit us without obtaining consent from our lenders. In addition, our financing agreement is secured by a first priority security interest in our trade accounts receivable, merchandise inventories, service marks and trademarks and other general intangible assets, including trade names. In the event of our insolvency, liquidation, dissolution or reorganization, the lenders under our financing agreement would be entitled to payment in full from our assets before distributions, if any, were made to our stockholders.

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

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

- suitable sites may not be available for leasing;
- we may not be able to negotiate acceptable lease terms;
- we might not be able to hire and retain qualified store personnel; and
- we might not have the financial resources necessary to fund our expansion plans.

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

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

Our stores are located in the western United States. Because of this, we are subject to regional risks, such as the economy, weather conditions, power outages, electricity costs and earthquakes and other natural disasters specific to the states in which we operate. For example, particularly in southern California where we have a high concentration of stores, seasonal factors such as unfavorable snow conditions (such as those that occurred in the winter of 2002-2003), inclement weather (such as the unusually heavy rains that occurred in winter 2004-2005) or other localized conditions such as flooding, fires (such as the major fires in 2003), earthquakes or electricity blackouts could harm our operations. State and local regulatory compliance also can impact our financial results. If the region were to suffer an economic downturn or other adverse regional event, our net

Table of Contents

sales and profitability and our ability to implement our planned expansion program could suffer. Several of our competitors operate stores across the United States and thus are not as vulnerable to these regional risks.

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

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

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

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

- earthquake, fire, flood and other natural disasters;
- power loss, computer systems failures, internet and telecommunications or data network failure, operator negligence, improper operation by or supervision of employees, physical and electronic loss of data or security breaches, misappropriation and similar events; and
- computer viruses.

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

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

We purchase merchandise from over 750 vendors. Although we did not rely on any single vendor for more than 6.2% of our total purchases during the fiscal year ended January 2, 2005, our dependence on principal suppliers involves risk. Our 20 largest vendors collectively accounted for 38.6% of our total purchases during the fiscal year ended January 2, 2005. If there is a disruption in supply from a principal supplier or distributor, we may be unable to obtain merchandise that we desire to sell and that consumers desire to purchase. In addition, a significant portion of the products that we purchase, including those

[Table of Contents](#)

purchased from domestic suppliers, are manufactured abroad. A vendor could discontinue selling products to us at any time for reasons that may or may not be in our control. Our net sales and profitability could decline if we are unable to promptly replace a vendor who is unwilling or unable to satisfy our requirements with a vendor providing equally appealing products.

Disruptions at shipping ports at which our products are imported could prevent us from timely distribution and delivery of inventory, which could reduce our sales and profitability.

From time to time, shipping ports experience capacity constraints, labor strikes, work stoppages or other disruptions that may delay the delivery of imported products. For example, the Port of Los Angeles, through which a substantial amount of the products manufactured abroad that we sell are imported, has experienced delays in distribution of products being imported through the Port to their final destination due to difficulties associated with capacity limitations. Future disruptions at a shipping port at which our products are received, whether due to delays at the Port of Los Angeles or otherwise, may result in delays in the transportation of such products to our distribution center and ultimately delay the stocking of our stores with the affected merchandise. As a result, our net sales, including same store sales, and profitability could decline.

Because all of our stores rely on a single distribution center and we are transitioning to a new distribution center, any disruption could reduce our net sales or increase our operating costs.

We currently rely on a single distribution center in Fontana, California. Any natural disaster or other serious disruption to the distribution center due to fire, earthquake or any other cause could damage a significant portion of our inventory and could materially impair both our ability to adequately stock our stores and our net sales, including same store sales, and profitability. If the security measures used at our distribution center do not prevent inventory theft, our gross margin may significantly decrease.

Due to limited capacity at the current distribution center, we entered into a 10-year lease with three five-year renewal options for a replacement distribution center in the second quarter of fiscal 2004. Construction began on the new distribution center in the third quarter of fiscal 2004. Construction has been substantially completed and we have started the transition to the new distribution center. We anticipate completion of construction early in the fourth quarter of fiscal 2005, with completion of the transition in the first quarter of fiscal 2006. Any disruption to, or delay in, this process could harm our future operations, particularly if the disruption affected our ability to adequately stock our stores during our important fourth fiscal quarter or increased our operating costs.

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

The Sarbanes-Oxley Act of 2002 (the "Act") that became law in July 2002, as well as new rules and regulations subsequently implemented by the SEC, have required changes in some of our corporate governance practices. In addition to final rules issued by the SEC, Nasdaq also revised its requirements for companies that are quoted on The Nasdaq Stock Market, Inc.'s National Market. These new rules and regulations have increased our legal

[Table of Contents](#)

and financial compliance costs and made some activities more difficult, time consuming and/or costly. These new rules and regulations have also made it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These new rules and regulations could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee, and qualified executive officers.

Risks Related to Our Industry

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

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

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

We experience seasonal fluctuations in our net sales and operating results. In fiscal 2004, we generated 27.8% of our net sales and 28.8% of our operating income in the fourth fiscal quarter, which includes the holiday selling season as well as the peak winter sports selling season. As a result, we incur significant additional expenses in the fourth fiscal quarter due to higher purchase volumes and increased staffing. If we miscalculate the demand for our products generally or for our product mix during the fourth fiscal quarter, our net sales could decline, resulting in excess inventory, which could harm our financial performance. Because a substantial portion of our operating income is derived from our fourth fiscal quarter net sales, a shortfall in expected fourth fiscal quarter net sales could cause our annual operating results to suffer significantly.

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

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

- other traditional sporting goods stores and chains;
- mass merchandisers, discount stores and department stores, such as Wal-Mart, Kmart, Target, Kohl's, JC Penney, and Sears;
- specialty sporting goods shops and pro shops, such as Foot Locker and Gander Mountain;

Table of Contents

- sporting goods superstores, such as Dick's Sporting Goods and The Sports Authority, Inc., and its other operating units, Oshman's, Sportmart and Gart Sports Company; and
- catalog and internet retailers.

Some of our competitors have a larger number of stores and greater financial, distribution, marketing and other resources than we have. Two of our major competitors, The Sports Authority, Inc. and Gart Sports Company (including its other operating units, Oshman's and Sportmart), completed a merger in August 2003 and now operate under the name The Sports Authority, Inc. In July 2004 two other sporting goods superstores combined when Dick's Sporting Goods, Inc. acquired Galyan's Trading Company, Inc. In 2004 the specialty outdoor superstores Gander Mountain Company and Cabela's Incorporated completed initial public offerings of their common stock, increasing their access to capital. If our competitors reduce their prices, it may be difficult for us to reach our net sales goals without reducing our prices. As a result of this competition, we may also need to spend more on advertising and promotion than we anticipate. If we are unable to compete successfully, our operating results will suffer.

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

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

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

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

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

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

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

Risks Related to Investing in Our Common Stock

The price of our common stock may be volatile.

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

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

We cannot predict the effect, if any, that the availability of shares of common stock for sale will have on the market price of our common stock prevailing from time to time. At September 23, 2005, there were 22,677,627 shares of our common stock outstanding. All of these shares are freely transferable without restriction or further registration under the federal securities laws, except for any shares held by our affiliates, sales of which will be limited by Rule 144 under the Securities Act of 1933. Sales of a significant number of these shares of common stock in the public market could reduce the market price of the common stock or our ability to raise capital by offering equity securities.

We cannot provide assurance that we will continue to declare dividends at all or in any particular amounts.

We intend to continue to pay quarterly dividends subject to capital availability and periodic determinations that cash dividends are in the best interest of us and our stockholders. Our dividend policy may be affected by, among other items, our views on potential future capital requirements, the terms of our debt instruments, legal risks, changes in Federal income tax law and challenges to our business model. Our dividend policy may change from time to time, and we cannot provide assurance that we will continue to declare dividends at all or in any particular amounts. A change in our dividend policy could have a negative effect on our stock price.

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

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

- a board of directors that is classified such that only one-third of directors are elected each year;
- authorization of the issuance of “blank check” preferred stock that could be issued by our board of directors to increase the number of outstanding shares and thwart a takeover attempt;
- limitations on the ability of stockholders to call special meetings of stockholders;
- prohibition of stockholder action by written consent and requiring all stockholder actions to be taken at a meeting of our stockholders; and
- establishment of advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings.

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are subject to risks resulting from interest rate fluctuations since interest on our borrowings under our financing agreement are based on variable rates. If the LIBOR rate

[Table of Contents](#)

were to increase 1.0% as compared to the applicable rate at July 3, 2005, our interest expense would increase \$1.1 million on an annual basis, based on the outstanding balance of our financing agreement at July 3, 2005. We do not hold any derivative instruments and do not engage in hedging activities.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Assistant Treasurer and Acting Controller, the latter two of whom currently are jointly performing the functions of principal financial officer and principal accounting officer pending the appointment of a new Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such terms are defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")). Based upon that evaluation, and because of the material weaknesses discussed below under "Changes in Internal Control", our Chief Executive Officer, Assistant Treasurer, and Acting Controller concluded that our disclosure controls and procedures were not effective as of July 3, 2005.

Changes in Internal Control Over Financial Reporting

As described in our Annual Report on Form 10-K for the fiscal year ended January 2, 2005, management conducted an assessment of the effectiveness of our internal control over financial reporting as of January 2, 2005, based upon *the Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this assessment, management concluded that, as of January 2, 2005, we did not maintain effective internal control over financial reporting. We identified the following material weaknesses in our internal control over financial reporting as of January 2, 2005:

1. We lacked the necessary depth of personnel with sufficient technical accounting expertise to ensure the preparation of interim and annual financial statements in accordance with generally accepted accounting principles. This material weakness in internal control over financial reporting contributed to a pervasive breakdown in the Company's interim and annual financial reporting processes. Specifically, account reconciliation and management review and approval controls did not operate effectively and, accordingly, generally accepted accounting principles were not properly applied resulting in the following:
 - a) Our policies and procedures did not provide for reconciliation of certain accounts payable subaccounts correctly or on a sufficiently frequent basis, resulting in material misstatements to accounts payable and cost of goods sold;

Table of Contents

- b) Operating expenses were misstated because our policies and procedures did not provide for the recognition of rent expense over the entire lease term of our store leases and did not provide for the recognition of landlord incentives as deferred rent, but instead reduced the value of our leasehold improvements;
- c) Inventory and cost of goods sold were misstated because we incorrectly capitalized certain buyer related costs to inventory, incorrectly determined the net realizable value of returned merchandise, and recorded sales of damaged or returned merchandise as an offset to inventory rather than as a sale;
- d) Inventory and accounts payable were materially misstated because our policies and procedures did not provide for the recognition of all inventory in-transit at period end;
- e) Revenue, cost of goods sold, inventory, and the allowance for sales returns were misstated because we did not provide an allowance for estimated sales returns; and
- f) Accrued liabilities were misstated because our policies and procedures did not provide for the reconciliation of certain subaccounts timely or provide for the recognition of changes in estimates and certain transactions in the correct accounting period.

This material weakness resulted in the material misstatement of our annual financial statements as of December 28, 2003, and for the fiscal years ended December 29, 2002 and December 28, 2003, and for the interim financial information for each of the interim periods in the fiscal year ended December 28, 2003, and for the first three interim periods in the fiscal year ended January 2, 2005, or represented more than a remote likelihood that a material misstatement of our annual or interim financial statements would not have been prevented or detected. As a result, we restated our consolidated financial statements as of December 28, 2003, and for each of the fiscal years ended December 29, 2002 and December 28, 2003, and for each of the interim periods in the fiscal year ended December 28, 2003, and for the first three interim periods in the fiscal year ended January 2, 2005, to reflect the correction of these errors in accounting.

- 2. We did not maintain effective controls over the documentation, review and approval of manual journal entries. Certain individuals could create record and approve the same journal entry without regard to the dollar amount of the transaction and without any further review or approval. In certain instances journal entries relating to different accounts were combined in a single compound journal entry. In other instances journal entries did not have sufficient supporting written explanation or sufficient supporting documentation and/or the supporting documentation had not been retained

Table of Contents

for a sufficient period of time. This material weakness resulted in material misstatements to amounts recorded for cost of goods sold, and selling and administrative expense. These material misstatements were corrected by restating the Company's consolidated financial statements as of December 28, 2003 and for each of the fiscal years ended December 29, 2002 and December 28, 2003, and for each of the interim periods in the fiscal year ended December 28, 2003, and for the first three interim periods in the fiscal year ended January 2, 2005.

There have been no significant changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during our fiscal quarter ended July 3, 2005 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. As a result of the identification of the material weaknesses described above, subsequent to the 13 weeks ended July 3, 2005 but prior to the filing of this Quarterly Report, we have taken the steps described below to reasonably assure remediation of these material weaknesses.

We have hired Barry Emerson, an individual with experience as a certified public accountant ("CPA") who we believe has a strong background in GAAP and SEC reporting to be our principal financial officer, who will have the title of Senior Vice President, Chief Financial Officer ("CFO") and Treasurer. Mr. Emerson began employment with the Company on September 12, 2005. Upon the completion of the filing of this Quarterly Report on Form 10-Q, Mr. Emerson will become the Company's Senior Vice President, Chief Financial Officer and Treasurer. Prior to the completion of this filing, Mr. Emerson served as a Senior Vice President with the Company. Mr. Emerson will be responsible for our accounting function (including the closing of our books and records), will be in charge of our public reporting and preparation of our financial statements, and will have responsibility for improving internal controls. Mr. Emerson will report directly to the Chief Executive Officer ("CEO"). Mr. Emerson will be in charge of our accounting department, and as such, senior accounting department personnel, including the Acting Controller and the Assistant Treasurer, will report to him. On August 5, 2005, we announced that we and our prior CFO had mutually agreed that he would resign from the positions of CFO and Treasurer, effective August 5, 2005, and that he would remain a Senior Vice President. Our Acting Controller and Assistant Treasurer currently jointly fulfill the functions of principal financial officer and principal accounting officer, pending the appointment of Mr. Emerson as CFO. We have also retained outside accounting consultants with significant SEC financial reporting experience to assist us. In addition, we will hire a CPA with public reporting experience at the assistant controller level. We also have implemented a policy requiring increased training and continuing education for certain members of our accounting department management, including persons with the responsibilities of CFO, controller and treasurer (including assistants).

We are in the process of instituting new procedures by which management performs account analysis and account reconciliations on a quarterly basis. For example, we are in the process of instituting procedures designed to enhance management's analysis and supervision of the identified accounts within accounts payable and reconciliations relating to those accounts to provide proper support for accounting entries. Management has designed procedures to identify and quantify buildups of unmatched credits in these

Table of Contents

accounts payable subaccounts, including any impacted by vendor returns. Management also has designed procedures to ensure that the quarterly analysis of all reserves and any related adjusting journal entries are supported with thorough analysis and documentation.

We have developed new journal entry procedures and policies to enhance supervision and review of entries, segregation of duties, documentation and document retention. In particular, the preparer of a journal entry may no longer approve his or her own journal entry. Moreover, prior to posting, the Controller's (or Acting Controller's) approval is required for journal entries with any line item \$20,000 and higher, and the CFO's approval (or Assistant Treasurer's approval prior to the filing of the Company's Quarterly Report on Form 10-Q for the second quarter of fiscal 2005) will be required if any line item is \$100,000 or higher. Journal entries for different accounts may not be combined or netted, all manual journal entries must include detailed descriptions and adequate supporting documentation, and manual journal entry documentation will be retained for at least seven years.

We will continue to implement and perform testing of these controls over the coming fiscal quarters and we believe that these policies and procedures will reasonably assure remediation of the material weaknesses in our internal control. Our Chief Executive Officer and our Assistant Treasurer and Acting Controller, the latter two of whom currently are jointly performing the functions of principal financial officer and principal accounting officer, believe that the subsequent procedures we performed in connection with our preparation of this Quarterly Report on Form 10-Q, including, in particular, increased review and analysis of transactions, account balances and journal entries in the areas where weaknesses were identified, provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our consolidated financial statements contained in this Quarterly Report on Form 10-Q.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projection of any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

On August 12, 2005, the Company was served with a complaint filed in the California Superior Court in the County of Los Angeles, entitled William Childers v. Sandra N. Bane, et al., Case No. BC337945 (“*Childers*”), alleging breach of fiduciary duty, violation of our bylaws and unjust enrichment by certain executive officers. This complaint was brought both as a purported stockholder class action and as a purported derivative action on behalf of the Company against all of the members of our board of directors and certain executive officers. The complaint alleges that our directors breached their fiduciary duties and violated our bylaws by, among other things, failing to hold an annual stockholders’ meeting on a timely basis and allegedly ignoring certain unspecified internal control problems, and that certain executive officers were unjustly enriched by their receipt of certain compensation items. The complaint seeks an order requiring that an annual meeting of our stockholders be held, an award of unspecified damages in favor of the Company and against the individual defendants and an award of attorneys’ fees. The Company believes that the complaint is without merit and intends to defend the suit vigorously. An adverse result in this litigation could harm our financial condition and results of operations, and the costs of defending this litigation could have a negative impact on our results of operations. The Company has indemnification agreements with each of its directors and executive officers. These agreements, among other things, provide for indemnification of the Company’s directors and executive officers for expenses, judgments, fines and settlement amounts incurred by any such person in any action or proceeding arising out of such person’s services as a director or executive officer or at our request, including as a result of this complaint, if the applicable director or executive officer acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the Company.

In addition, the Company is involved in routine litigation incidental to the conduct of its business. The Company believes that no other litigation currently pending against it will have a material adverse impact on its business, financial position or results of operations. The Company may enter into discussions regarding settlement of lawsuits to which it is a party if it believes settlement is in the best interests of the Company and its stockholders. In accordance with Statement of Financial Accounting Standards No. 5, “Accounting for Contingencies,” the Company has made accruals with respect to these lawsuits, where appropriate, which are reflected in the Company’s unaudited condensed consolidated financial statements.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

[Table of Contents](#)

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits

Exhibit Number	Description of Document
31.1	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of Acting Controller (jointly performing the function of principal financial officer with the Assistant Treasurer).
31.3	Rule 13a-14(a) Certification of Assistant Treasurer (jointly performing the function of principal financial officer with the Acting Controller).
32.1	Section 1350 Certification of Chief Executive Officer.
32.2	Section 1350 Certification of Acting Controller (jointly performing the function of principal financial officer with the Assistant Treasurer).
32.3	Section 1350 Certification of Assistant Treasurer (jointly performing the function of principal financial officer with the Acting Controller)

SIGNATURES

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

**BIG 5 SPORTING GOODS CORPORATION,
a Delaware corporation**

Date: September 30, 2005

By: /s/ Steven G. Miller
Steven G. Miller
President and Chief Executive Officer

Date: September 30, 2005

By: /s/ Elizabeth F. Chambers
Elizabeth F. Chambers
Acting Controller
(Co-Principal Financial and Accounting Officer)

Date: September 30, 2005

By: /s/ Thomas L. Robershaw
Thomas L. Robershaw
Assistant Treasurer
(Co-Principal Financial and Accounting Officer)

CERTIFICATIONS

I, Steven G. Miller, President and Chief Executive Officer, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Big 5 Sporting Goods Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 30, 2005

/s/ Steven G. Miller

Steven G. Miller

President and Chief Executive Officer

CERTIFICATIONS

I, Elizabeth F. Chambers, Acting Controller, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Big 5 Sporting Goods Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 30, 2005

/s/ Elizabeth F. Chambers

Elizabeth F. Chambers

Acting Controller (jointly performing the function of principal financial officer with the Assistant Treasurer)

CERTIFICATIONS

I, Thomas L. Robershaw, Assistant Treasurer, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Big 5 Sporting Goods Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 30, 2005

/s/ Thomas L. Robershaw

Thomas L. Robershaw
Assistant Treasurer (jointly performing the function of
principal financial officer with the Acting Controller)

**CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF
THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Big 5 Sporting Goods Corporation (the "Company") on Form 10-Q for the period ending July 3, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven G. Miller, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Steven G. Miller

Steven G. Miller

President and Chief Executive Officer

September 30, 2005

A signed original of this written statement required by Section 906 has been provided to Big 5 Sporting Goods Corporation and will be retained by Big 5 Sporting Goods Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF
THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Big 5 Sporting Goods Corporation (the "Company") on Form 10-Q for the period ending July 3, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Elizabeth F. Chambers, Acting Controller of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Elizabeth F. Chambers

Elizabeth F. Chambers

Acting Controller (jointly performing the function of principal financial officer with the Assistant Treasurer)

September 30, 2005

A signed original of this written statement required by Section 906 has been provided to Big 5 Sporting Goods Corporation and will be retained by Big 5 Sporting Goods Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF
THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Big 5 Sporting Goods Corporation (the "Company") on Form 10-Q for the period ending July 3, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Thomas L. Robershaw, Assistant Treasurer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Thomas L. Robershaw

Thomas L. Robershaw

Assistant Treasurer (jointly performing the function of principal financial officer with the Acting Controller)

September 30, 2005

A signed original of this written statement required by Section 906 has been provided to Big 5 Sporting Goods Corporation and will be retained by Big 5 Sporting Goods Corporation and furnished to the Securities and Exchange Commission or its staff upon request.